THE FLORIDA
BAR JOURNAL
VOLUME LXX, NO. 11 DECEMBER 1996
ADVANCING THE COMPETENCE AND PUBLIC RESPONSIBILITY OF LAWYERS

Arbitration Agreements: Choice of Law Questions

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Cover art by Joe McFadden

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Oath of Admission to The Florida Bar

The general principles which should ever control the lawyer in the practice of the legal profession are clearly set forth in the following oath of admission to the Bar, which the lawyer is sworn on admission to obey and for the willful violation to which disbarment may be had.

"I do solemnly swear:

"I will support the Constitution of the United States and the Constitution of the State of Florida;

"I will maintain the respect due to courts of justice and judicial officers;

"I will not counsel or maintain any suit or proceedings which shall appear to me to be unjust, nor any defense except such as I believe to be honestly debatable under the law of the land;

"I will employ for the purpose of maintaining the causes confided to me such means only as are consistent with truth and honor, and will never seek to mislead the judge or jury by any artifice or false statement of fact or law;

"I will maintain the confidence and preserve inviolate the secrets of my clients, and will accept no compensation in connection with their business except from them or with their knowledge and approval;

"I will abstain from all offensive personality and advance no fact prejudicial to the honor or reputation of a party or witness, unless required by the justice of the cause with which I am charged;

"I will never reject, from any consideration personal to myself, the cause of the defenseless or oppressed, or delay anyone's cause for lucre or malice. So help me God."

LETTERS

Kudos

Your story in the October *Journal* on Chief Justice Gerald Kogan was the best thing I have ever read about a sitting judge. And the photographs of the judge and his family fully portray what a wonderful warm person he is.

JOSEPH F. JENNINGS

Miami

Lands for Future Schools

Regarding "School Impact Fees in Florida" (May), there is an additional concept that needs to be taken into account: impact fee credits for deeded or nondeeded lands for future school sites.

Large developments are required to set aside and deed for public use land, *i.e.*, parks, police and fire stations, libraries, and schools. If the calculation for school impact fees includes land that is required to be deeded for such use, this credit is an unplanned windfall for developers. The developer can treat these impact fee credits as a security. The school impact fee credits can be sold, traded, or used by the original developer.

These school impact fee credits were not originally anticipated by the developers in their due diligence. This credit was shown in documentation submitted by developers to lending institutions. What is the equitable solution? Land value for a new school is less than five percent of the total cost. Take land value out of the school impact fee calculation. The net effect is a school impact fee that is about five percent less. But now there is "a rational connection between the need created and the fee paid."

Aequitas nonquam contravent leges . . . . Equity never contravenes the laws.

JOHN P. MOYLAN

Flagler Beach

ADA and Reasonable Accommodation

In "Americans With Disabilities Act Obligations and Employer Knowledge" (October), the author suggests that an employer is not required to offer a reasonable accommodation to a disabled individual who does not first request one. Even then, the request must be specific and reasonable, not just a vague plea for "help" of some undefined nature. Although this view is understandable from an employer's standpoint, it may place too great a burden on disabled individuals in some cases and too little of an obligation on employers who know or reasonably ought to know of the need for reasonable accommodation from sources other than the employee.

Obviously, as the author states, an employer cannot be charged with failing to reasonably accommodate a disability of which it has absolutely no knowledge because the ADA only requires an employer to accommodate "known" disabilities. However, the author overlooks the critical point that it is knowledge—and not how that knowledge is obtained—which is the triggering mechanism under the statute. While an employer might learn of an employee's disability from the employee, there are many other possible sources of this knowledge, including the employee's doctor, family or friends, coworkers, supervisors, and customers or

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clients. A disability would be "known" if it were gleaned from any of these sources just the same as if the employee told the employer directly.

Therefore, it should not be an absolute requirement that an employee initiate the accommodation process in every single case. In fact, the EEOC regulations interpreting the ADA suggest that "[t]his process of identifying whether, and to what extent, a reasonable accommodation is required should be flexible and involve both the employer and the individual with a disability." 29 C.F.R. Part 1630 Appendix. This flexibility is warranted because many employees may not fully understand their rights under the ADA and the statute places the burden of compliance on employers. Florida anti-discrimination law is likely to follow the ADA's lead. *See Brand v. Florida Power Corp.*, 633 So. 2d 504 (Fla. 1st DCA 1994).

If an employer "knows"—from a source other than the employee—that a reasonable accommodation is needed in a particular case, its obligations have been triggered and there is no reason to require the employee to make a formal request or speak some "magic words" to activate the ADA. Such a requirement would only allow a convenient escape hatch for employers seeking to avoid their obligations and, in addition, would create an added barrier for potentially deserving claimants who, because of personal reasons or out of real concern about their economic circumstances, may not be inclined to ask for the help they need. However, even if one accepts the idea that imposing a duty of followup on an employer with knowledge is not too onerous a burden in light of the intended reach and remedial purposes of the ADA, we still arrive back at the threshold question: When is a disability "known" to the employer?

This is really a two-part question. Without getting into a metaphysical debate over what it means to "know" something, we safely can adopt a common sense working definition keyed to awareness and perception rather than certainty or validity. One court has proffered the following: "[a]n employer knows an employee has a disability when the employee tells the employer about his condition, or when the employer otherwise becomes aware of the condition, such as through a third party or by observation." *Schmidt v. Safeway, Inc.*, 864 F. Supp. 991, 997 (D. Or. 1994). In most cases, the issue of what an employer knew and when the employer knew it will be a fairly straightforward inquiry for the trier of fact to resolve without resort to clairvoyants or soothsayers.

The second part of the question relates exactly to "what" the employer must have knowledge of in order for ADA obligations to be triggered. There are detailed definitions of "disability" in both the ADA and the EEOC's interpretive regulations, which language ultimately will control the liability issues in the case. However, for purposes of the employer knowledge requirement, it would appear a risky strategy for an employer to require an employee to prove a case before the employer is willing to offer an accommodation. Rather, the prudent employer will work with any employee who may have a potentially credible ADA claim (which again is a common sense factual inquiry for the factfinder) to explore accommodations that balance the needs of individuals and the workplace. Employers who refuse to accept this obligation as a cost of doing business under the ADA do so at their peril.

TIMOTHY TACK
Tampa

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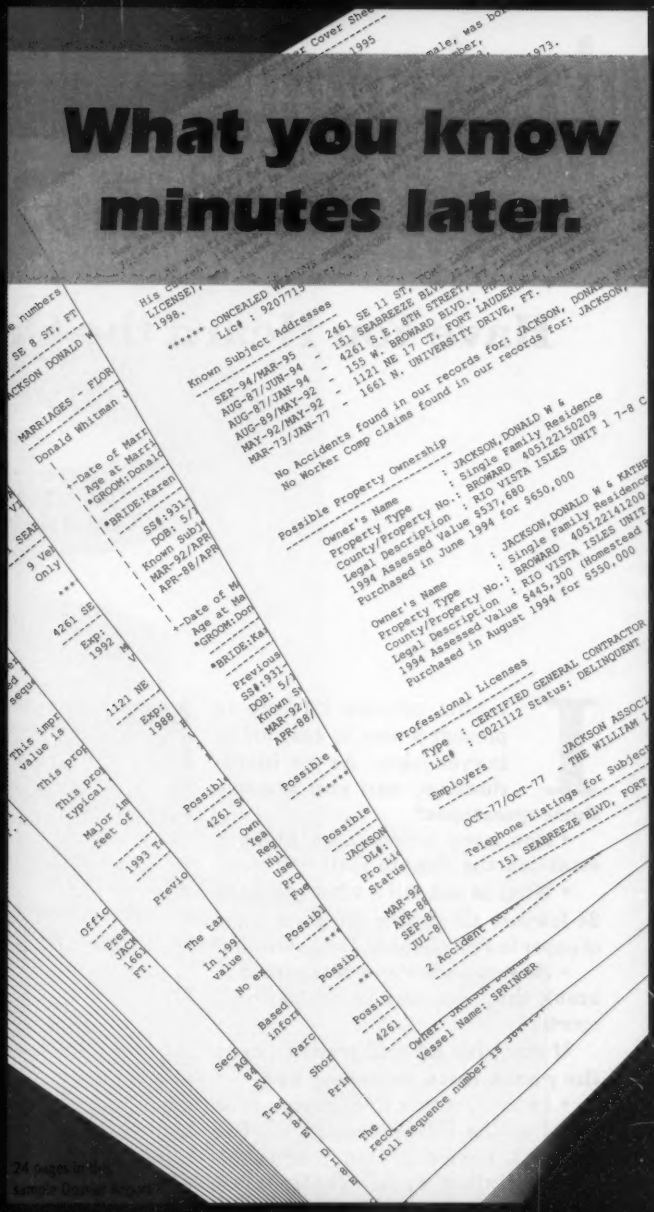

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Have You Heard the One About the Lawyer . . .

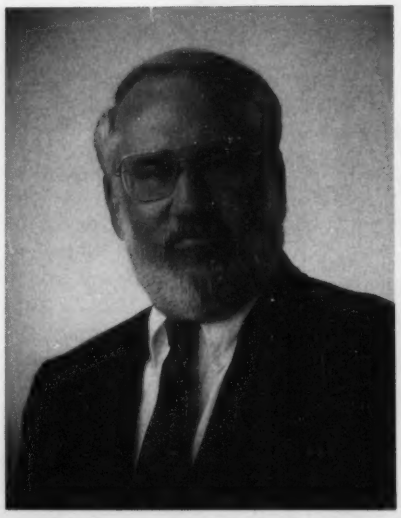
"My native country, thee,
Land of the noble free . . . ."
— *S. F. Smith*

In this column I'd like to present a way to respond to lawyer jokes. **As an introduction, can you answer these questions?**

- How many lawyers does it take to establish the Senate Hall of Fame?
- What do you call it when you have 24 lawyers all signing the same piece of paper in Philadelphia, Pennsylvania?
- How many lawyers does it take to break the color line in professional sports?

If you give up and want to hear the punch lines, here they are:

- In 1957, it took five lawyers to be called by the U.S. Senate its top five senators, named in that year to the Senate Hall of Fame. The greatest senators, all lawyers, were Webster, Clay, Calhoun, La Follette and Norris.
- You call it "The Declaration of Independence" when you speak of these lawyers who, with patriots of other trades and professions, signed the original parchment document in 1776. In it, they pledged to support the rights claimed in the declaration—to support them with "our lives, our fortunes and our sacred honor." Many of that number were to ultimately make good their pledges, because a good number lost property, and several lost their lives in the War for Independence that followed.
- It only took one courageous, stubborn, and color-blind baseball manager—Branch Rickey—to take the step that first integrated major league baseball. It was Rickey who hired Jackie Robinson to play second base for the old Brooklyn Dodgers. Rickey was a lawyer.



As a matter of fact, at least three other lawyers have made a difference in pro baseball. Lawyer Miller Huggins was long-time manager of the New York Yankees. Kennesaw Mountain Landis was a highly respected commissioner of baseball and a former federal judge. Tony La Russa, a Florida State University College of Law graduate, was the manager who took his St. Louis Cardinals to this year's National League championship playoffs.

A listing of lawyers who have made a crucial difference in the history of the United States would be long enough to fill up the equivalent of a huge stack of lawyer-joke books. And although it would not be helpful to lawyers for us to lose our collective sense of humor, it is important to cultivate in ourselves and our friends and neighbors a sense of law as a noble and needed profession.

From the time our nation was in its birth pangs, lawyers have often been counted among those citizens willing to make personal and professional sacrifices for the rights and freedoms they believed crucial to the lives of their communities and families. The 24 lawyers who signed the Declaration of Independence realized they took great risk. If the British won the war, they knew, they likely would not escape the British hangman, and they certainly would never practice law again.

Even though the Colonies won, the lawyers who had taken such a public stand with their pens in Philadelphia suffered hardship and danger during the war. Three Southern lawyer-signers were captured with American troops in Charleston, one having been wounded. Their homes and lands were raided and commandeered, and property confiscated or burned. All were offered Royal protection if they renounced their political principles, but they refused. One patriot, a Boston-born lawyer, never recovered his losses. He caught malaria during efforts to escape the Tories and died sick and ruined financially. By the time Tories realized the location of the Princeton, New Jersey, home of one lawyer-signer, he had used up all his personal supplies feeding, clothing, and resting the continental army as it marched south. Eventually, he died of complications from a cold

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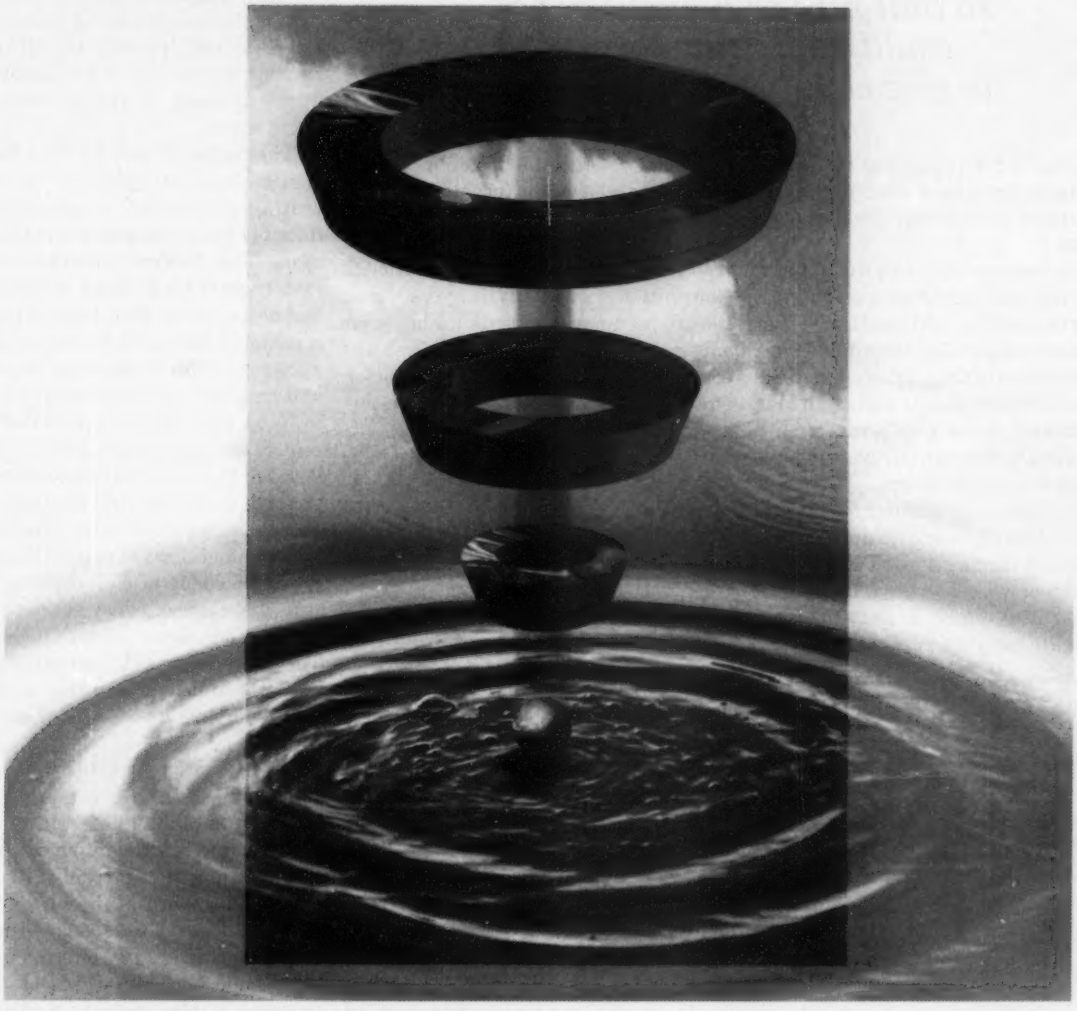

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On each side, researching, listening, . . . was a lawyer, each struggling against the other so that jury or judicial panel could help draw the line to give equal protection to all

contracted in a Tory jail, but not before the British rampaged over his estate and burned his library, the finest in America.

These lawyers certainly did not represent the only profession of patriots willing to sacrifice in those "times that tried men's souls." But they did leave a noble tradition of the kind of citizen and the kind of leader that is willing to take a stand and make a difference. And other lawyers through our history have followed in their footsteps.

Historians have said our four greatest presidents were Washington, Jefferson, Lincoln, and FDR. All but Washington were lawyers. The present governor and one U.S. Senator from Florida are both lawyers. In fact, each of these two statesmen has been both governor and senator for our state.

Here's another question: When the newly independent 13 colonies sent representatives to the first Constitutional Convention, how many lawyers did it take to hammer out a balance between government power and individual liberty that has been the organic basis for our 220-year-old democracy? The answer is, it took 29 lawyers who were part of the 55-delegate convention in 1787.

Soon the young nation's leaders realized that the Constitutional draft needed stronger guarantees of personal freedoms. Lawyers engaged in sometimes heated dialogue over thorny political issues to help create the Bill of Rights—the first 10 Constitutional Amendments, all dealing with varying guarantees of individual liberty. And lawyer influence did not stop there. Only a year after the Constitution was created, lawyers in both federal and state governments stood with, argued for, and wrote letters and petitions for citizens whose First Amendment freedom—freedom of speech—had been taken away.

The Sedition Act of 1798 had imposed harsh punishment on anyone writing, publishing, or speaking "with intent to defame" Congress or the President. The federal government ultimately paid back those whose liberty had been denied. But there still existed a national necessity to strike the balance between the security of a nation and the rights of that nation's citizens to speak their minds. It was the lawyer and Supreme Court Justice Oliver Wendell Holmes who helped clarify this thorny question by declaring the amount of freedom to be influenced by the circumstances in which the freedom is exercised. It is Holmes who wrote, "the character of every act depends on the circumstances in which it was done. The most stringent protection of free speech would not protect a man in falsely shouting 'fire' in a theater and causing panic."

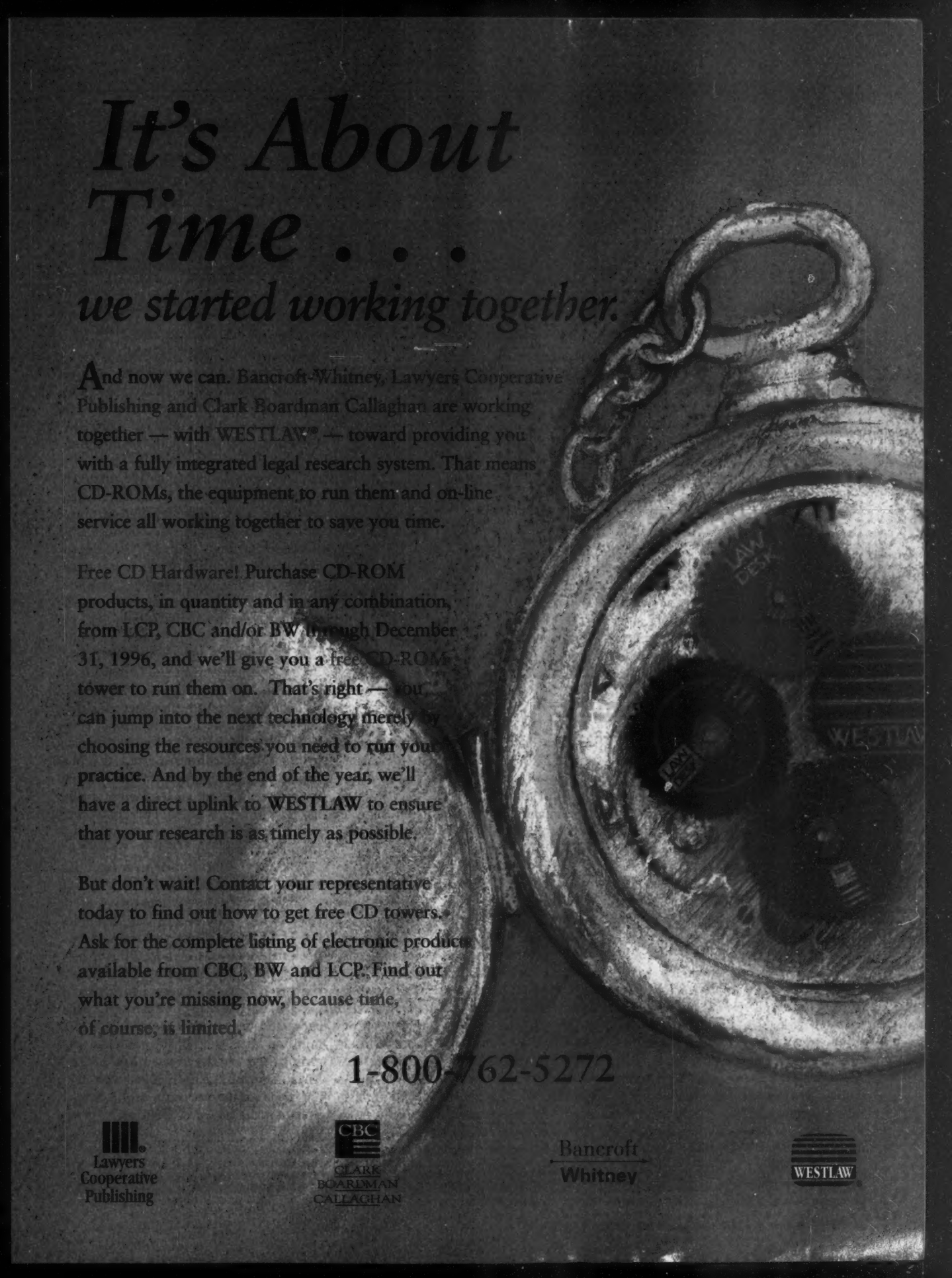
Many court battles have been fought, up to the present day, over where that public safety line of free speech must be drawn in a free nation. Every time, an individual has demanded to express himself or herself freely; and every time, a governmental body has claimed its right to curb that expression because of its potential to threaten public security. And on each side, researching, listening, counseling, and arguing was a lawyer, each struggling against the other so that jury or judicial panel could help draw the line most likely to give equal protection to all.

It is a fact that, partly because of such legal conflicts and the part lawyers have played in them, all Americans—those who love lawyer jokes and those who hate them—have a right to disagree with the prevailing opinion in their community and their nation. It is because of lawyers, actually, that lawyer bashers have a guaranteed right to tell lawyer jokes.❑

JOHN W. FROST, II

It's About Time . . .

we started working together.



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Board of Governors Reflects Bar Membership

You may have seen reports in the Bar *News* recently about Board of Governors discussions on board apportionment and composition. Those discussions prompted me to review the present make-up of the board, which includes 45 elected circuit representatives, the president and president-elect, the president and president-elect of the Young Lawyers Division, and two public members appointed by the Supreme Court.

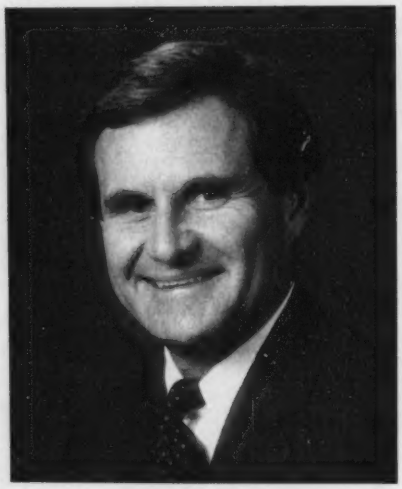
That review led me to the conclusion that our present Board of Governors is composed of well-seasoned practicing lawyers whose experience and goals for our profession closely reflect those of a majority of our membership.

I have heard criticisms over the years that the Board of Governors is a "good old boys" club of "silk stocking" lawyers who do not share the average Bar member's concerns about managing a hectic schedule, covering the office overhead, and spending more time with the family. If that was ever true, it is not true of the current board.

The biographical data sheets we ask each board member to complete show that about three-quarters of current board members come from firms with 10 or fewer lawyers.

Figures were available for 46 of the board's 49 attorney members, and of those 35, or 76 percent, were in firms of 10 or fewer lawyers. Seventeen board members were in firms with four or fewer attorneys, including four sole practitioners. Several more come from firms with no more than 20 lawyers. Those figures also show the typical board member has been practicing law for more than 20 years, most commonly in the area of civil litigation.

As President John Frost, II, summed up for the *News*, "What this shows is that the Board of Governors is very representative of the type of firm practicing in Florida. The Board of Governors is very representative of the sole and small practitioner firms."



President Frost has been in practice for 27 years, and now has eight lawyers in his Bartow firm.

The board membership is close to overall Bar demographics. Surveys show about 71 percent of Florida lawyers practice in firms of 10 or fewer attorneys and 11 percent—about the same percentage as on the board—come from 11- to 20-attorney firms.

The board also has been taking steps in recent years to ensure it stays in touch with the concerns of most practitioners. The annual All Bar Conference and membership attitude and economics surveys have provided valuable guidance to the board, as have meetings between board leaders and leaders of our sections and committees.

Each section is invited to address the board at least once each year to share the concerns of members practicing in the section's area. The president and president-elect also receive annual reports from each of our sections and committees, so that they may keep up-to-date on the issues affecting the broadest cross-section of the membership possible.

The Bar also has an active outreach program to the state's local and specialty bar associations through our Public Information and Bar Services Department, which organizes the annual Bar Leaders Conference and publishes the *Bar-to-Bar Briefs* newsletter. The president and president-elect also meet frequently with the local bars, both to keep the grassroots informed on what the Bar has been doing in our many areas of responsibility and to learn how we can better serve the membership.

Individual board members also are active in their local associations, routinely meeting with the local bars, writing newsletter columns, and engaging in continuing dialogue with the lawyers in their area about issues facing us all. By my count, 12 of our current board members have served as president of their local bars, and many more have served on the local bars' boards of directors or key committees.

Perhaps the most innovative step the Board of Governors has taken in recent years to make certain it is reflective of the views of most of our members is to establish an open forum at the start of each regular board meeting to hear from any Florida lawyer who cares to address the board. The "60 minutes with the board" sessions are announced on the front page of the *News*. I encourage each of you to watch for those announcements and to come by when the board is meeting in your area. ❑

John F. Harkness, Jr.

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ARBITRATION AGREEMENTS: Analyzing Threshold Choice of Law and Arbitrability Questions

An Often Overlooked Task

by Michael A. Hanzman

In recent years many business enterprises have turned to mandatory arbitration clauses in hopes of avoiding time-consuming, uncertain, and expensive litigation. It is perceived that arbitration agreements will provide the parties with a quick, efficient, and economical method of resolving disputes before panels of trained arbitrators, as opposed to whimsical juries. According to proponents, this alternative dispute resolution system, with its limited discovery procedures and motion practice, poses a much less significant burden, both on the parties and the court system. Proponents also tout arbitration's perceived benefit of offering greater certainty due to extremely restricted judicial review and the reduced exposure to punitive and other exemplary type damages because, at least in theory, arbitrators will be less inclined than jurors to grant such relief.

While the arbitration versus litigation debate is subject to many divergent views, it is clear that the number of industries electing arbitration as the preferred choice of dispute resolution is quickly on the rise. Mandatory arbitration clauses are becoming standard in many contracts, including agreements between customers and securities broker-dealers, franchisors and franchisees, employment contracts, insurance agreements, construction contracts, and agreements between professional service providers and their respective clients. As a consequence, attorneys are now faced with a host of new issues, many of which require considerable analysis. A failure to spot these issues and address them appropriately can severely prejudice a client's cause.

The purpose of this article is to introduce practitioners to some of the critical issues that must be addressed when confronted with either the task of drafting a mandatory arbitration clause or disputes involving such agreements. Threshold questions that must be analyzed include: 1) whether federal or state law will govern the procedural and substantive aspects of the agreement; 2) whether a particular dispute is within the scope of an arbitration clause and therefore "arbitrable"; 3) whether a contractual choice of law provision can operate to impair an otherwise valid arbitration agreement or restrict an arbitrator's jurisdiction; and 4) whether courts or arbitrators will decide threshold issues of arbitrability.

A Brief History

In 1925, Congress enacted the Federal Arbitration Act (FAA or "act"), codified at 9 U.S.C. §1, *et seq*. This legislation was designed to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 1242 (1985), and to place such agreements "upon the same footing as other contracts." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 94 S. Ct. 2449, 2453 (1974). Section 2 of the act provides that any written agreement to arbitrate "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. The Supreme Court has unequivocally pronounced that this section of the act constitutes a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. Its effect "is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act," *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S. Ct. 927 (1983), and when applicable, the act controls proceedings in both federal and state courts. *Southland Corp. v. Keating*, 465 U.S. 1, 104 S. Ct. 852 (1984).

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While the FAA was undoubtedly designed to encourage the use of arbitration as an expeditious alternative dispute resolution, its passage "was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered." *Byrd*, 105 S. Ct. at 1242. The act does not require parties to arbitrate where they have not agreed to do so, nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 109 S. Ct. 1248 (1989). Rather, the act "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Id.* at 1255. Stated differently, the FAA makes arbitration agreements as enforceable as other contracts, but not more so. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801 (1967).

Following the lead of Congress, many states, including Florida, have also legislated the field of arbitration. Like §2 of the FAA, F.S. §682.01, *et seq.*, known as the "Florida Arbitration Code," specifically provides that a written contractual provision for the settlement by arbitration of any controversy shall be valid, enforceable, and irrevocable without regard to the justiciable character of the controversy. The code provides a mechanism whereby parties to an arbitration agreement may seek to compel its performance, and it mandates that courts confirm arbitration awards unless one of the specified (and narrow) grounds for vacating an award is established. *See* F.S. §§682.12, 682.13.

Based upon the dictates of pertinent legislation, both federal and state courts have embraced the view that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration," *Moses H. Cone*, 103 S. Ct. at 941, as well as the corollary axiom that "arbitration is a favored means of dispute resolution and courts shall indulge every reasonable presumption to uphold proceedings resulting in an award." *Roe v. Amica Mut. Ins. Co.*, 533 So. 2d 279, 281 (Fla. 1988).

Interplay Between the FAA and State Laws

Although federal and most state legislation favor arbitration agreements, state statutes and case law governing the arbitration process vary significantly. In many instances, state law is inconsistent with either explicit or implicit provisions of the FAA. For example, F.S. §682.11 provides that certain expenses, *not including attorneys' fees*, shall be paid as provided in the award. This provision was initially interpreted as prohibiting arbitrators from awarding attorneys' fees. *Insurance Co. of North America v. Acousti Eng'g Co.*, 579 So. 2d 77 (Fla. 1991).

The Supreme Court of Florida held that parties may voluntarily agree to allow the collateral issue of attorneys' fees to be decided in arbitration together with the underlying dispute

The Supreme Court of Florida, relying upon the current policy expanding the scope of arbitrable issues, recently receded from this restrictive view and held that parties may voluntarily agree to allow the collateral issue of attorneys' fees to be decided in arbitration together with the underlying dispute. *Turnberry Assocs. v. Service Station Aid*, 651 So. 2d 1173 (Fla. 1995). The court nevertheless maintained the position that an arbitrator has no authority to award attorneys' fees absent an express waiver of what it described as a "statutory right" to have the court decide the fee issue. *Id.* In contrast, cases decided under the FAA have held that an agreement for the arbitration of any controversy between the parties provides arbitrators with the authority to award attorneys' fees as part of their broad power to fashion appropriate remedies, provided an underlying statutory or common law basis for the award of such fees is present. *See Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991); *Prudential-Bache Securities, Inc. v. Depew*, 814 F. Supp. 1081 (M.D. Fla. 1993).

Similarly, while the FAA is silent on the issue of whether arbitrators have the authority to award punitive damages, some states, such as New York, have denied arbitrators such authority, even if agreed upon by the parties. *See Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976). This prohibition rests on the premise that the enforcement of an arbitrator's award of punitive damages, as a purely private remedy, violates public policy. Other states go even further by rendering pre-dispute written arbitration agreements invalid and unenforceable. *See, e.g.*, Ala. Code §8-1-4(3)(1993). These examples of situations where state law can impair an otherwise broad and unrestricted arbitration agreement are merely illustrative and not exhaustive.

In *Southland*, the Supreme Court addressed the question of whether a particular state law governing arbitration agreements conflicted with the FAA, thereby violating the supremacy clause of the U.S. Constitution. In *Southland*, a franchisor and certain of its franchisees entered into contracts providing that any controversy or claim arising out of, or relating to, their agreements would be settled by arbitration.

Ignoring the arbitration clause, several franchisees filed individual state court actions against the franchisor alleging fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and a violation of the disclosure requirements of the California Franchise Investment Law. Despite the breadth of the arbitration provision, the California Supreme Court refused to compel arbitration of the Franchise Investment Law claims, relying upon a section within the statute providing that any condition, stipulation, or provision requiring any franchisee to waive compliance with any provision of the law is unenforceable. The state court interpreted this provision to require judicial consideration of claims brought under that statute and concluded that it did not run afoul of the FAA.

Reversing, the U.S. Supreme Court initially observed that the FAA rests on the authority of Congress to enact substantive rules under the commerce clause. In exercising this authority, Congress withdrew the power of the states to require a judicial forum for the resolution of claims which the contract-

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ing parties agreed to resolve by arbitration. There is nothing in the act indicating that the broad principal of enforceability, as reflected in §2, is "subject to any additional limitations under state law." *Southland,* 104 S. Ct. at 858. Recognizing that the purpose of the act was to assure those who bargained for arbitration that their expectations would not be undermined by federal judges, or by state courts or legislatures, the *Southland* Court held that in creating a substantive rule applicable in state and federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.

Applying this same reasoning, the Court, three years later, concluded that the FAA preempts a provision within the California Labor Code authorizing employees to maintain an action for wages, despite the existence of an agreement to arbitrate any controversy between the employee and his or her employer. *Perry v. Thomas*, 482 U.S. 483, 107 S. Ct. 2520 (1987).

During its most recent term, the Court also held that a Montana statute requiring notice that a contract compelling mandatory arbitration be "typed in underlined capital letters on the first page of the contract" conflicted with, and was therefore displaced by, the FAA's broad enforceability mandate. *Doctor's Assocs. v. Casarotto*, ___ U.S. ___, 116 S. Ct. 1652 (1996). *See also David L. Threlkeld & Co. v. Metallgesellschaft, Ltd.*, 923 F.2d 245 (2d Cir. 1991) (Vermont statute voiding certain arbitration agreements preempted by FAA); *S+L+H S.p.A. v. Miller-St. Nazianz, Inc.*, 988 F.2d 1518 (7th Cir. 1993) (Wisconsin Fair Dealership Law could not void choice of parties to arbitrate dispute).

Effect of Choice of Law Provisions

While the *Southland*, *Perry*, and *Doctor's Associates* cases confirm that the FAA preempts any state law that infringes upon or restricts a valid arbitration agreement, the question remained whether arbitration agreements containing a choice of law provision evidence an intent on the part of the parties to apply a state law that conflicts with the FAA's broad policy of enforcement. In other words, was the conflicting state law preempted by the FAA, as would be the case absent the choice of law clause, or did the generic choice of law provision operate to incorporate the anti-arbitration state law into the agreement? The Supreme Court first addressed this issue in *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.,* 489 U.S. 468, 109 S. Ct. 1248 (1989).

The Supreme Court reiterated that the interpretation of private contracts is ordinarily a question of state law

In *Volt*, the parties entered into a construction contract for the installation of a system of electrical conduits in the appellee's college campus. The contract contained an agreement to arbitrate all disputes between the parties arising out of, or relating to, the contract or the breach thereof, as well as a choice of law clause providing that the agreement would be governed by the law of the place where the project was located, which was California.

When a dispute arose regarding compensation to be paid under the agreement, the appellant made a formal demand for arbitration. In response, the appellee filed an action in state court alleging fraud and breach of contract, and brought third party claims for indemnity against two other companies involved in the construction project, with whom it did not have an arbitration agreement. The appellee then moved to stay the arbitration proceedings in accordance with a provision within the California Civil Procedure Code that permitted a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by the arbitration agreement, where there was a possibility of conflicting rulings on common issues of law or fact. Applying this provision, the trial court stayed the arbitration proceeding pending the outcome of the related litigation.

The California Court of Appeal affirmed, holding that by specifying that their contract would be governed by the law of the place where the project was located, the parties had incorporated the California rules of arbitration into their agreement. Since the purpose of the FAA was to provide for the enforcement of privately negotiated arbitration agreements, the California court concluded that federal law did not have preemptive effect in a case where the parties had chosen in their arbitration agreement to abide by state rules of arbitration.

After accepting review, the Supreme Court reiterated that the interpretation of private contracts is ordinarily a question of state law which it did not sit to review. *Volt*, 104 S. Ct. at 1253. The Court then concluded that the California courts' interpretation of the choice of law provision to mean that the parties intended to apply the California rules of arbitration, including the stay provision, did not offend the federal policy favoring arbitration since there is no federal policy favoring arbitration "under a certain set of procedural rules." *Id.* at 1254. Emphasizing that the FAA does not reflect a congressional attempt to occupy the entire field of arbitration, the Court found that nothing in the California statute conflicted with the accomplishment and execution of the objectives of Congress, so as to undermine the goals and policies of the FAA. *Id.* at 1256.

After the Court issued its decision in *Volt*, litigants began to rely upon choice of law provisions in an attempt to divest arbitrators of the authority to enter awards which, in the absence of the choice of law provision, would clearly be permissible. The most glaring example was posed by cases where the underlying contract incorporated the law of a state that did not allow arbitrators to award punitive damages.

Prior to *Volt*, courts had generally rejected such arguments, concluding that choice of law provisions in a contract governed by the FAA merely designated the substantive law that arbitrators must apply, but did not deprive the arbitrators of their authority to award a particular remedy. *See Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378

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(11th Cir. 1988). Seizing upon *Volt*, which by implication rejected this substantive law limitation, litigants persuaded certain courts that a general choice of law clause evidenced the parties' intent to incorporate a given state's complete body of law, including statutes and case law governing the arbitration process and restricting the authority of arbitrators to award particular relief. *See Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (2d Cir. 1991).

Other courts disagreed and continued to look to federal common law to decide the scope of an arbitration panel's authority, notwithstanding the presence of a choice of law provision. *See Raytheon Co. v. Automated Business Sys.*, 882 F.2d 6 (1st Cir. 1989); *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993). This conflict among the federal circuits caused the Supreme Court once again to address the effect choice of law clauses have on otherwise unbridled arbitration agreements.

In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, ___ U.S. ___, 115 S. Ct. 1212 (1995), the Court was presented with a securities trading account contract specifying that it would "be governed by the laws of the State of New York." *Id.* at 1217. In the underlying arbitration, the respondents argued that this clause incorporated New York's rule prohibiting arbitrators from awarding punitive damages and thereby divested the arbitration panel of authority to enter such an award. The arbitration panel disagreed and issued a punitive damage award. During post-arbitration proceedings, the district court vacated the punitive damage award based upon the choice of law provision. The U.S. Court of Appeals for the Seventh Circuit affirmed, relying in large part on the Supreme Court's *Volt* decision. *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir. 1994).

To resolve this conflict, the Supreme Court first observed that the FAA's pro-arbitration policy did not operate without regard to the wishes of the contracting parties. *Mastrobuono*, 115 S. Ct. at 1216. Citing *Volt*, the Court reiterated that, just as parties may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted. *Id.* On the other hand, the Court also emphasized that when contracting parties agree to arbitrate all claims, including claims for punitive damages, the FAA ensures that their agreement will be enforced according to its terms, even if a rule of state law would otherwise exclude such claims from arbitration. *Id.* The Court therefore concluded that "the case before us comes down to what the contract has to say about the arbitrability of petitioners' claim for punitive damages." *Id.*

Just as parties may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted

Addressing that issue, the Court pointed out that two contractual provisions were at issue; the first being the choice of law provision, and the second being the recitation that "any controversy" arising out of the transactions between the parties shall be settled by arbitration. *Mastrobuono*, 115 S. Ct. at 1217. The agreement contained no express reference to punitive damage claims. The Court then proceeded to resolve the issue through common law contract interpretation analysis. It concluded that the choice of law provision, when viewed in isolation, could reasonably be read as merely a substitute for the conflicts of law analysis that otherwise would determine which substantive law to apply to disputes arising out of the contractual relationship. *Id.* The Court also opined that even if the reference to the laws of the State of New York was more than a substitute for ordinary conflicts of law analysis, the provision could be read to include only New York substantive rights and obligations, and not the state's allocation of power between alternative tribunals. *Id.* It was clear, however, that neither provision contained an unequivocal exclusion of punitive damage claims.

To support its conclusion that the contract did not express an intent to preclude an award of punitive damages, the Court found that, at most, the choice of law clause introduced an ambiguity in the arbitration agreement that should be construed against the interest of the party that drafted it. *Mastrobuono*, 115 S. Ct. at 1219. The Court also emphasized that the agreement should be read to give effect to all its provisions and to render them consistent with each other, and held that the generic New York choice of law provision did not operate to limit the scope of the broad arbitration clause by divesting the arbitrators of authority to award punitive damages. The Court also noted in passing that it was unlikely that customers signing such an agreement were actually aware of New York's bifurcated approach to punitive damages, or had any idea that by signing the agreement they might be giving up an important substantive right. *Id.*

What is significant about the *Mastrobuono* decision is that it does not rest upon any federal versus state law constitutional analysis. Rather, the Court, consistent with its prior decisions, reiterated that arbitration agreements should be enforced according to their terms and that issues regarding the scope of an arbitration clause should be controlled by the intent of the parties.

In *Volt*, the Court did not disturb the state court's conclusion that the choice of law clause incorporated state procedural rules governing arbitration, one of which called for arbitration to be stayed pending resolution of a related judicial proceeding. That procedural rule, however, related only to the order of the proceedings. It did not affect the enforceability of the arbitration agreement itself, nor did it limit the authority of the arbitrators. Under such circumstances, the Court held that applying that state rule would not undermine the goals and policies of the FAA. By contrast, in *Mastrobuono*, the Court engaged in its own contractual interpretation and concluded that the choice of law provision could not operate to incorporate a state law that would impair the ability of the arbitrator to issue a remedial award (*i.e.*, punitive damages).

The message derived from these decisions is, in this author's opinion, clear.

Generic choice of law provisions cannot be used to incorporate into an arbitration agreement state law which, in the absence of the choice of law provision, would be preempted by the FAA. But, as was the case in *Volt*, state procedural rules that do not undermine the enforceability of an otherwise valid contract to arbitrate may be deemed to have been incorporated into contracts through choice of law provisions. And as courts, including the U.S. Supreme Court, have consistently reminded, nothing in the FAA prevents a party from explicitly excluding claims, including statutory claims and punitive damage claims, from the scope of an agreement to arbitrate. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 105 S. Ct. 3346 (1985); *Raytheon Co. v. Automated Business Sys.*, 882 F.2d 6 (1st Cir. 1989) (parties that want arbitration provisions to exclude punitive damages claims are free to draft agreements that do so explicitly); *Marschel v. Dean Witter Reynolds, Inc.*, 609 So. 2d 718 (Fla. 2d DCA 1992) (parties are free to limit scope of arbitration agreement or to designate that certain issues such as limitation defenses will not be arbitrable).

While deciphering the interplay between federal and state arbitration rules is not an easy task, the decisions discussed above establish certain fundamental principles. The FAA undeniably evidences a liberal policy favoring arbitration agreements, without regard to any contrary state substantive or procedural policies.

Any state body of law, either statutory or common, that conflicts with the underlying purpose of the FAA must, under the weight of the supremacy clause, "give way." *Perry*, 107 S. Ct. at 2526. The act does not, however, mandate the arbitration of claims. It simply guarantees the enforcement of privately negotiated arbitration agreements according to their terms. *Volt*, 109 S. Ct. at 1248 (1989). Parties are, therefore, free to choose to abide by state rules that govern any aspect of the arbitration, just as they are free to contractually limit the issues that will be arbitrated or the relief that the arbitrators may award. An intent to do so, however, must be explicit and will not be inferred through generic choice of law clauses when such an inference will affect the enforceability of, or place substantive restrictions upon, the arbitration agreement itself. These principles apply to arbitration agreements within the purview of the act, whether the issue is presented in state or federal court, *Southland*, 104 S. Ct. at 859, which begs the question of when a contract "evidence[s] a transaction involving interstate commerce," thereby implicating the FAA's broad enforcement policy.

The answer to this question is critical because absent the applicability of the FAA, state law will control, even when a particular jurisdiction renders predispute arbitration agreements totally unenforceable. *See Howard Fields & Assocs. v. Grand Wailea Co.*, 848 F. Supp. 890 (D. Haw. 1993).

An Interstate Commerce Transaction

To satisfy the jurisdictional reach of §2 of the FAA, several state and federal courts initially interpreted the act to require the parties to have contemplated an interstate commerce connection. This "contemplation of the parties" test focused not on whether the transaction implicated interstate commerce, but whether the parties, at the time they entered into the transaction and accepted the arbitration clause, contemplated substantial interstate activity. If the parties did not contemplate an interstate commerce connection, these courts refused to apply the act, even though interstate commerce concerns were clearly implicated. Other courts interpreted the act's jurisdictional scope as reaching to the limits of Congress' commerce clause power and attaching to any transaction which, in fact, involved interstate commerce.

In *Allied-Bruce Terminix Cos., Inc. v. Dobson*, ___ U.S. ___, 115 S. Ct. 834 (1995), the Supreme Court resolved this conflict and concluded that the phrase "involving commerce" as used in the act was the functional equivalent of the phrase "affecting commerce" which has been interpreted as signaling a congressional intent to exercise its commerce clause powers to the fullest extent. The Court held this broad interpretation was consistent with the act's basic purpose of putting arbitration provisions "on the same footing" as other contracts and with Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the commerce clause. *Id.* at 840. Finding that the "contemplation of the parties" stan-

dard would simply invite disputes regarding what was initially contemplated by the parties, the Court reasoned that such a result would promote the type of costly litigation the act was designed to avoid. *Id.* at 841.

The Court also believed that resolution of the "contemplation of the parties" analysis would often turn on happenstance and reasoned that extending the reach of the act to any contract that implicated interstate commerce would be consistent with its earlier pronouncements holding that the act displaced contradictory state law. The Court therefore adopted a "commerce in fact" interpretation of the act's jurisdictional language, holding that the legislation was triggered when the transaction involved interstate commerce, even if the parties did not contemplate any significant interstate commerce connection. *Id.* at 843.

Applying the "commerce in fact" standard adopted in *Allied-Bruce*, it is obvious that most contractual arrangements will fall within the purview of the FAA. *Allied-Bruce* itself involved a case in which the respondent, a homeowner in Alabama, had bought a lifetime "termite protection plan" from the local office of Allied-Bruce Terminix Company, a franchise of Terminix International Company. Based upon the multi-state nature of Allied-Bruce's business, and the fact that materials it used came from outside Alabama, the parties did not even contest whether the transaction involved interstate commerce, even though they had "contemplated" a transaction that was primarily local. One should therefore assume that any commercial contract of significance will in all likelihood implicate, and be governed by, the FAA.

The Question of Arbitrability

1) *What Claims Are Arbitrable?*

Because both federal and state courts have embraced a liberal policy guaranteeing the enforcement of arbitration agreements, it is generally accepted that absent the parties' clear intent to the contrary, broad arbitration clauses will apply to a wide variety of claims, including those founded on statutory rights. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 111 S. Ct. 1647 (1991) (age discrimination claim); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987) (Securities Exchange Act and RICO claims); *Mitsubishi Motors Corp.*, 105 S. Ct. at 3348 (international antitrust claims); *Folkways Music Publishers, Inc. v. Weiss*, 989 F.2d 108 (2d Cir. 1993) (copyright claims); *Richardson Greenshields Sec., Inc. v. McFadden*, 509 So. 2d 1212 (Fla. 2d DCA 1987) (claim involving violation of state wiretap statute).

The arbitration provision should be drafted so as to clearly memorialize the client's intent, and should explicitly exclude any claims the client does not want to submit to arbitration

In determining whether particular claims are arbitrable, the parties' intentions, construed in favor of arbitrability, control, but courts will nevertheless carefully review arbitration agreements "in order not to force a party to submit to arbitrate a question which he did not intend to be so submitted." *G & N Constr. Co. v. Kirpatovsky*, 181 So. 2d 664, 667 (Fla. 3d DCA 1966). *See also Road Sprinkler Fitters Local Union No. 669 v. Independent Sprinkler Corp.*, 10 F.3d 1563 (11th Cir. 1994) (duty to arbitrate arises out of contract and party cannot be required to arbitrate any dispute outside scope of agreement).

Based upon these principles, courts have held that broad clauses providing for the arbitration of "any and all controversies" or "any dispute" relating to or arising out of a particular agreement will encompass all claims of any nature arising out of the relationship between the parties, including tort claims. *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382 (11th Cir. 1996); *Grektorp v. City Towers of Florida, Inc.*, 644 So. 2d 613 (Fla. 2d DCA 1994). In such circumstances, only the most forceful evidence of an intent to exclude the claim from arbitration can prevail. *Beaver Coaches, Inc. v. Revels Nationwide R.V. Sales, Inc.*, 543 So. 2d 359 (Fla. 1st DCA 1989). On the other hand, more restrictive clauses, such as those providing for arbitration relating to "the interpretation, performance, or breach of any provision..." of an agreement have been held not to cover disputes, such as tort claims, which do not raise an issue the resolution of which requires a reference to or construction of some portion of the contract itself. *See, e.g., Terminix Int'l Co., L.P. v. Michaels*, 668 So. 2d 1013 (Fla. 4th DCA 1996); *see also CSE, Inc. v. Barron*, 620 So. 2d 808 (Fla. 2d DCA 1993). The question of whether a claim falls within the scope of an arbitration agreement turns on the nature of the underlying dispute, rather than labels attached to the legal causes of action asserted. *Gregory*, 83 F.3d 382, 384.

Since the issue of arbitrability often turns upon precise contract language, it is incumbent upon counsel, retained to draft arbitration agreements, to inquire as to whether the client desires to arbitrate all controversies, including tort and statutory claims, or wishes to arbitrate only those claims requiring a reference to, or interpretation of, the underlying contract.

The arbitration provision should be drafted so as to clearly memorialize the client's intent, and should explicitly exclude any claims the client does not want to submit to arbitration. Examples could be tort claims, statutory claims, claims for punitive damages, or claims for attorneys' fees. While a contract that clearly and unambiguously excludes such claims from the scope of the arbitration agreement will be enforced, an ambiguous contractual provision could easily result in a client being forced to arbitrate claims it never intended to submit to alternative dispute resolution.

Likewise, practitioners faced with situations involving a dispute that may be subject to arbitration should thoroughly analyze the applicable arbitration provision to determine which claims asserted by or against the client are, in fact, arbitrable. Failure to assert the existence or enforceability of a binding arbitration agreement could result in the client's being deemed to have waived the right to arbitrate. On the other hand, a failure to analyze the contract and apply the correct body of case law could result in a client's being forced to arbitrate a claim outside the

scope of the arbitration clause.

2) *Do Courts or Arbitrators Determine Questions of Arbitrability?*

Because disagreements regarding the scope of an arbitration clause often arise, courts were presented early on with the issue of whether the court or the arbitrator had the authority to decide whether a party had agreed to arbitrate a particular type of dispute. The resolution of this threshold issue is of critical importance, since it will dictate whether a court or an arbitration panel will ultimately determine the underlying merits of a particular case.

Not surprisingly, when the Supreme Court was called upon to decide this question it concluded that just as the arbitrability of the merits of a dispute depends upon whether a party agrees to arbitration, the question of who has the primary power to decide arbitrability "turns upon what the parties had agreed about *that* matter." *First Options of Chicago, Inc. v. Kaplan*, ___ U.S. ___, 115 S. Ct. 1920, 1923 (1995).

If the parties agreed to submit the arbitrability question itself to arbitration, the arbitrators have authority to determine this jurisdictional issue. If, on the other hand, the parties did not agree to submit issues of arbitrability to arbitration, then the court should decide the question "just as it would decide any other question that the parties did not submit to arbitration, namely independently." *Id.* at 1924. As it had in the past, the Court again emphasized that this conclusion flowed inexorably from the fact that arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration. *Id.*

Following the lead of *Mastrobuono*, the *Kaplan* Court concluded that when deciding whether the parties had agreed to arbitrate a certain matter (including arbitrability), courts generally should apply ordinary state-law principles that govern the formation of contracts. *Id.* It then added an important qualification applicable when courts decide whether a party has agreed that an arbitrator should decide arbitrability: A court should not assume that the parties agreed to arbitrate the issue of arbitrability unless there is clear and unmistakable evidence that they did so. *Id.* Courts therefore treat silence or ambiguity about the question of who decides arbitrability differently from the way they treat silence or ambiguity about the question of whether a particular merit-related dispute is arbitrable.

When addressing the latter question, the court engages in the presumption that any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. In the former instance, the presumption is reversed, thereby requiring clear and unmistakable evidence that the parties intended to submit the arbitrability question to arbitration. The reason behind this seeming inconsistency is that a failure to require clear and unmistakable evidence on this point might "too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide." *Id.* at 1925. Most state courts have likewise held the threshold issues of arbitrability should be decided by the courts, not the arbitrators themselves. *See, e.g., Florida Education Association / United v. Sachs*, 650 So. 2d 29 (Fla. 1995) (courts should determine whether party, by subsequent conduct, waived contractual right to arbitrate).

Since courts addressing this issue look primarily to the intent of the parties, counsel drafting arbitration agreements can dictate where questions of arbitrability will be resolved. If it is the client's desire to err on the side of arbitrating all claims, counsel may wish to provide in the agreement that all questions involved in the dispute between the parties, including the arbitrability of any controversy, shall be decided by the arbitration panel. On the other hand, if a client wants to ensure that only specified claims will be subjected to arbitration, the clause should be drafted to explicitly provide that the court shall decide all threshold issues of arbitrability. Similarly, practitioners addressing disputes subject to arbitration should carefully review the contract at issue and, when appropriate, request that the court determine the threshold arbitrability of a particular claim. A failure to timely raise these jurisdictional issues could result in the client being forced to arbitrate a claim outside the scope of the agreement or, at the very least, result in the client being forced to arbitrate threshold issues of arbitrability.

Conclusion

While cases addressing aspects of the arbitration arena are being decided at a rapid pace, the authorities discussed above clearly convey the message that arbitration agreements, like any other contract, will be construed to effectuate the intent of the contracting parties. In most situations, these agreements are cloaked with a strong presumption of enforceability, and any doubts concerning their scope are resolved in favor of arbitration, "whether the problem at hand is the construction of contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone*, 103 S. Ct. at 941.

Parties are nevertheless at liberty to draft their arbitration agreements so as to exclude any claims they do not wish to submit to alternative dispute resolution. Drafters therefore should consult with their clients and make sure that the agreements explicitly memorialize their intent. Similarly, counsel faced with disputes involving arbitration clauses should carefully analyze threshold choice of law and arbitrability issues at the commencement of any proceeding. Since these issues can be outcome-determinative, and can dictate the forum in which a dispute will be resolved, they should not be glossed over or addressed on an "as needed" basis.❑

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Florida's New Petroleum Contamination Reimbursement Program

by Samuel J. Morley

During the 1996 Regular Session, the Florida Legislature passed a bill[1] that continues the 1995 work shutdown at sites covered by Florida's financially strapped petroleum cleanup reimbursement program. The bill also implements a comprehensive overhaul of the reimbursement program that affects a wide range of interests including property owners, lenders, and contractors. This article examines the background leading up to the 1996 legislative efforts, including the 1995 work moratorium,[2] and the more significant provisions of the 1996 bill.

The Reimbursement Program: A Victim of Its Own Success?

The petroleum cleanup reimbursement program was first instituted in 1986 with the passage of the State Underground Petroleum Environmental Response Act (SUPER Act).[3] This ground-breaking legislation paved the way for a framework that addressed cleanup of petroleum-contaminated sites, in particular those sites reported and registered pursuant to the Early Detection Incentive (EDI) program.[4] Sites reported by the owner or operator under the EDI program before the legislative deadline were eligible for restoration funding. To fund the program, the SUPER Act created the Inland Protection Trust Fund (IPTF), which receives its revenues primarily from an excise tax on each barrel of petroleum products.[5]

Under the EDI program, the Florida Department of Environmental Protection ("the department" or DEP) developed a prioritization schedule utilizing a scoring system that ranks highest the most environmentally hazardous sites.[6] The original program offered the owner a choice between having a state contractor clean up the site or the owner funding the cleanup through a private contractor and being reimbursed later by the program.[7] Most owners chose the state contractor, due to the risks associated with the reimbursement option. Soon, however, it became obvious that thousands, not hundreds of sites, were being reported, and the state was forced to rely more on private reimbursement cleanups. Thus, later legislative sessions added several attractive features to the reimbursement program that led to a rapid expansion of claims under the program.

First, beginning in 1987, an owner/operator could be reimbursed after completing each task, as opposed to completing the entire job, which often took years.[8] Second, interest was provided in 1992 for overdue claims.[9] Finally, contractors were not required to obtain approval from the department prior to cleanup of a site. The contractor simply submitted its reimbursement claim after each task, and the department began processing the claim on a first-come, first-served basis regardless of the environmental threat posed by the site.[10]

The reimbursement option under the EDI program was a huge success. It was later extended to allow additional sites to apply.[11] Following the EDI program, the legislature created several other reimbursement programs to remediate petroleum product contamination.[12] These include the Petroleum Liability Insurance Program (later renamed the Petroleum Liability and Restoration Insurance Program (PLIRP)) in 1988[13] and the Abandoned Tank Restoration Program (ATRP) in 1990.[14] And even for those who failed to qualify for these programs, there was the "Good Samaritan" provision, which allowed them to seek reimbursement if they cleaned up their contaminated property and were not associated with the pollution.[15]

Soon the number of sites enrolled in the programs ballooned; as of early 1995, there were 5,600 sites with work in progress.[16] The number of reimbursement claims and the backlog of unpaid claims rose accordingly. By late 1995, the backlog of applications for claims submitted under the reimbursement program totalled $266 million, with a

Art by Joe McFadden

portion of these claims drawing interest.[17] Other outstanding claims not yet submitted were estimated at an additional $63 million, bringing the total outstanding claim amount to $323 million.[18] This amount far outstripped the approximately $100 million that was and continues to be available for cleanup each year from the IPTF. Of particular concern were the many low-priority ranked sites that accounted for approximately 50 percent of the ongoing site cleanups and low- and mid-priority sites comprising almost 80 percent of the reimbursed amounts.[19]

In 1994, the reimbursement program came under criticism for the rising backlog, coupled with charges of poor management and lack of cost controls. A statewide grand jury ultimately investigated, issuing a report critical of the program.[20]

1995 Moratorium Bill

To get a handle on the growing backlog and continued flood of new claims, in 1995 the legislature acted quickly and passed a "moratorium" bill,[21] suspending reimbursement for certain work commenced after March 27, 1995.[22]

The 1995 moratorium bill immediately shut down state-funded cleanup of hundreds of low-priority sites across the state.[23] For work to begin again, preapproval from the department was required for the scope of work and costs associated with site rehabilitation.[24] Thus, the first-come, first-served system was replaced with a system that concentrated on the worst sites first.

The immediate effect of the bill was to stop the financial bleeding and give the legislature some breathing room to work out a consensus on overhauling the program. A legislative task force convened, and two comprehensive bills circulated in a concerted effort by both houses to address the program's financial woes. The respective House and Senate committees reported favorably on the bills, but neither house adopted them.[25]

Over the second half of 1995, the effects of the moratorium became clear. Several Florida-based petroleum contamination remediation companies experienced work slowdowns and either scaled back work or became insolvent.[26] On the public sector side, the moratorium was criticized by South Florida representatives who were concerned about the cleanup delays, in particular the work shut-down at many low-ranked sites in Broward and Dade counties.[27]

The "moratorium" bill, passed by the legislature in 1995, imposes comprehensive cost-saving measures to reduce reimbursement claims and the financial burden on the IPTF

The moratorium language also generated uncertainty. For example, many lending and real estate transactions were based on the assumption that a low-priority site would be cleaned up. What would happen to the site now that cleanup had been discontinued? What criteria would ultimately govern preapproval of funded work? If the work did not resume, would the property be the subject of an enforcement by some local governments or a lawsuit by a third party? In order to address these and other issues, the department issued several memoranda explaining the preapproval system and imposing price templates to arrive at unit costs for various rehabilitation programs tasks and standard formats for contractors to be used as guidance in submitting proposals.[28]

Questions persisted, however, and pressure mounted for the legislature to enact a comprehensive fix to the program's financial and technical problems. In particular, the department needed guidance from the legislature as to how to finance and pay off the backlog.[29]

The 1996 Legislation

The House Natural Resource Committee convened a workgroup during the summer and fall of 1995 and early 1996, in order to develop legislation agreeable to interested parties. Some of these ideas made their way into draft legislation. During the 1996 Regular Session, CS/HB 1127 circulated through various committees, prompting vigorous debate and numerous amendments. Near the end of the session, the bill appeared on the House and Senate floor and, to the surprise of many, passed with remarkably little floor debate. It became effective July 1, 1996.

What does the bill do? Most importantly, it imposes comprehensive cost-saving measures to reduce reimbursement claims and the financial burden on the IPTF. The bill restructures the program in several ways to implement the changes imposed by the moratorium bill and offers other streamlining changes. Finally, the bill creates a new amnesty program that provides an opportunity for state-funded cleanups at sites not eligible under other programs. These provisions are discussed in detail below.

• *The Backlog*

The "Achilles heel" of the program was the huge backlog of unpaid reimbursement claims. Without addressing that issue, no headway could be made on proper cost control mechanisms for cleanup of the remaining sites. The basic dilemma was whether to pay the backlog with the income stream from the fund alone. Contractors would be paid quickly, but less money would be available for cleanup halted under the moratorium. On the other hand, if the state borrowed the money through a financing arrangement (*e.g.*, issuance of certificates or other evidence of indebtedness), the backlog would be paid off quickly but additional interest would be accrued by the state that could otherwise be used for cleanup.[30]

After heated debate in committee, the legislature opted for early payoff of the backlog. The bill creates a not-for-profit corporation, the Inland Protection Financing Corporation (IPFC), to issue certificates or other evidence of indebtedness to pay the backlog. The IPFC receives an annual appropriation from the IPTF of up to $65 million per fiscal year to pay the backlog, and the term of any evidence of indebtedness is restricted to six years.[31]

In an effort to make more funds available to pay off the backlog, the bill imposes a discounting feature that forces applicants seeking reimbursement to take a discount after January 1, 1997. The bill requires DEP to establish a payout schedule based on $100 million in annual revenues, and it directs the

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IPFC to pay applicants an amount of approved claims discounted by 3.5 percent.[32]

With the backlog repayment scheduled at $65 million per year, an additional $65 million will be available for new work (which includes $10 million for the pre-approved voluntary cleanup, discussed below), state-contracted cleanups, and amnesty programs. The rest of the fund revenue ($30 million) will be spent on enforcement and administrative costs.[33]

• *Pre-approval in Priority Order/Criteria Imposed*

The bill adopts the pre-approval system that was first addressed in the 1995 moratorium bill, and it requires that all program tasks initiated on or after March 29, 1995, be conducted on a pre-approved basis in priority order, with sites posing the greatest threat addressed first.[34]

How will the department approve costs and rehabilitation actions? The legislation gives some flexibility to the department in this area. For example, the department is authorized to utilize competitive bid procedures or negotiated contracts.[35] On the other hand, to exclude "fly-by-night" operations, the new law requires contractors to meet certain "beefed up" minimum criteria to participate in the program.[36] The department also may withhold up to 25 percent of the payment due (or require a performance bond) to assure that the contractor satisfactorily completes the work. In addition, the department may terminate the contractor's eligibility for participation in the program if the contractor fails to perform its contractual duties.[37]

There are also certain exceptions to cleanup based on priority order. Owners/operators of high-priority sites scored above 50 that are in the remedial action phase (and allowed to continue work under the moratorium bill) may request approval to complete site rehabilitation under the new pre-approval process. Although this allows some sites to be cleaned up ahead of others with higher scores, it avoids disrupting ongoing cleanup activities.[38]

• *Deadline for Remaining Work in Progress*

As noted, the moratorium bill shut down work at many sites. Those sites authorized to continue despite the moratorium were allowed no further reimbursement under the reimbursement program as of August 1, 1996. Thereafter, reimbursement applications for partially completed tasks may be submitted. All reimbursement applications must be submitted by December 31, 1996.[39]

• *Risk-Based Corrective Action (RBCA) Approach*

When does the legislation deem a rehabilitated site to be clean? During the 1995 and 1996 legislative sessions, many argued that the financial constraints imposed on the program necessitated an RBCA approach.[40] This approach allows the department to authorize cleanup of sites to "target levels" lower than those levels currently allowed. Although only intended for sites where public drinking water resources would not be affected, the RBCA concept generated a good deal of controversy, and was partly responsible for the legislative breakdown in 1995.[41]

Ultimately, the department could incorporate RBCA principles in establishing its cleanup criteria rule. The bill lists various factors that DEP must consider.[42] First, the point of compliance—ordinarily at the source of the petroleum contamination—may, under certain conditions, be temporarily moved to the property boundary if cleanup (including cleanup by natural attenuation) is progressing.[43] Further, the department may extend the point of compliance beyond the property boundary to facilitate natural attenuation, provided there are no adverse environmental impacts. This latter provision was somewhat controversial and language was added to require public notice of the extension.[44] Specifically, where RBCA allows temporary extension of the point of compliance beyond the property boundary, notice to local governments and the affected adjacent landowner is required.[45]

Second, although the cleanup target levels are ordinarily water quality standards (or if not in existence, other minimum criteria based on a lifetime cancer risk factor of 1.0E-6), alternate cleanup levels may be appropriate at a particular site depending on the quality of the groundwater and the use of the groundwater in the vicinity of the site.[46]

The department is currently involved in rulemaking efforts to implement the RBCA provisions. Draft amendments to the department's petroleum cleanup rule[47] have been circulated, and the department held workshops on August 15, and October 16 amd 17, 1996, to consider public input. Among other provisions, the proposed amendments identify the criteria for determining when alternative cleanup target levels are justified and when natural attenuation is appropriate as a remediation strategy.[48]

• *A Second (or Third?) Chance: New Amnesty Program and Redetermination*

Provisions

It is estimated that despite the programs dating back to 1986, some of which were extended to provide owners with a second chance, there are still approximately 4,000 additional sites (with a cleanup tab of $750 million) not currently eligible under existing programs.[49] Any new program would trigger significant monetary obligations on the state's part. This issue became very controversial during the 1996 Session.[50]

The legislature chose a middle ground. The Petroleum Cleanup Participation Program (PCPP) allows persons ineligible under the older programs (*e.g.*, EDI program, ATRP, and PLIRP) up to $300,000 of restoration funding for property contaminated by discharges of petroleum or petroleum products occurring prior to January 1, 1995.[51] However, the bill does not give participating sites a completely "free ride." The bill requires a 25 percent copayment and the submittal of a limited contamination assessment report (LCAR) unless the applicant is financially unable to pay. In those cases, these obligations may be reduced or eliminated. Financial capability is evaluated based on a consideration of the owner's net worth.[52]

The bill contains relief provisions that provide site owners with a second chance to qualify under existing programs under which they were previously deemed ineligible. Specifically, the bill authorizes redetermination of eligibility under the ATRP and PLIRP programs. If a site owner was denied coverage under ATRP because of failure to close the site due to financial inability, the department is authorized to waive the tank closure requirements.[53] Furthermore, if the site was certified as insured but nevertheless was denied PLIRP coverage for other reasons, PLIRP eligibility may now be available if the owner requests a re-evaluation by December 31, 1996.[54] Potentially affected owners and operators should consider reapplying under these provisions.

Also, the June 30, 1996, ATRP application deadline is waived for financially incapable owners.[55]

• *Voluntary Cleanup*

The "Good Samaritan" program allowed persons not liable for the petroleum discharge and ineligible under other programs to volunteer to clean up the site at their own expense. Assuming prior approval from the department, such volunteers could later be reimbursed from the fund.[56] Concern was raised, however, about the program's impact on the financial stability of the fund, which was already overtaxed by current obligations. On the other hand, without some form of voluntary cleanup, properties would needlessly remain contaminated.[57] As a compromise measure, the bill deleted the Good Samaritan provision, but created the Preapproved Advanced Cleanup (PAC) program which, beginning January 1, 1997, provides for voluntary cleanup at a site on a limited basis in advance of that site's priority ranking.[58] The program requires a commitment to co-pay no less than 25 percent of the cleanup costs and a limited contamination report to support and estimate the cost of the proposed action.[59] The department ranks PAC applications, with the highest ranking given to the applicant that bids the highest percentage of cost

sharing.[60] The bill authorizes $10 million annually for work authorized under PAC contracts, with not more than $500,000 going to any one facility in each fiscal year.[61]

With the exception of this program, persons who conduct voluntary site cleanups prior to the site reaching priority ranking for restoration funding will not be eligible for repayment. However, nothing in the legislation prevents persons not seeking reimbursement from cleaning up sites as long as all environmental standards are met.[62] Furthermore, for voluntarily cleaned up sites with releases reported prior to January 1, 1995, the department must issue a "No Further Action" notice at contaminated sites with priority ranking scores of 10 or less.[63]

• *Third Party Actions*

The 1996 legislation insulates facility owners from administrative or judicial actions brought by a state, local government, or any other person to compel rehabilitation before that site reaches its cleanup rank or to pay for rehabilitation costs from an eligible discharge.[64] Similar insulating language in Florida's Drycleaning Contamination Cleanup Act[65] has raised a good deal of controversy around the state,[66] particularly in Dade County, where the local environmental agency has attempted to proceed with enforcement actions against site owners despite the state-imposed ban.[67] It will be interesting to see if any local government does the same regarding the immunity contained in the tanks bill.

For voluntarily cleaned up sites with releases reported prior to January 1, 1995, the department must issue a "No Further Action" notice at contaminated sites with priority ranking scores of 10 or less

The immunity provision does not preclude any person from bringing a civil action for damages or personal injury.[68]

Conclusion

Rapid and substantial legislative developments have occurred in the tanks program. With a new financial structure to address the backlog, the program is again funding sites and is in fact larger now than it has ever been. The new work, including thousands of new sites added under the new amnesty program, should invigorate various sectors of the Florida economy, including remedial contractors, property owners, and testing laboratories. ❑

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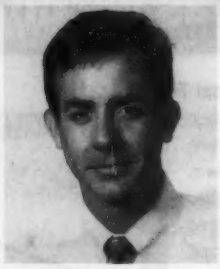

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[1] Fla. Laws ch. 96-277.

[2] *Id.* ch. 95-2.

[3] *Id.* ch. 86-159.

[4] FLA. STAT. §376.3071(12).

[5] *Id.* §206.9935(3); the excise tax currently generates $172 million annually, and after deducting the seven percent general revenue surcharge, the department has about $160 million (if appropriated) to spend on cleanup. HOUSE OF REPRESENTATIVES AS FURTHER REVISED BY THE COMMITTTEE ON NATURAL RESOURCES FINAL BILL ANALYSIS & ECONOMIC IMPACT STATEMENT at 3 (May 16, 1996) (hereinafter HOUSE BILL ANALYSIS).

[6] FLA. ADMIN. CODE ch. 62-771.

[7] Compare the State Cleanup Program, FLA. STAT. §376.3071(9), and the Reimbursement Program, FLA. STAT. §376.3071(12).

[8] Fla. Laws ch. 87-374, §3, codified at FLA. STAT. §376.3071(12)(b)1 (1995).

[9] *Id.* ch. 92-30, §7, codified at FLA. STAT. §376.3071(12)(d)2 (1995) (authorized interest on the amount of reimbursable costs for applications filed after Aug. 14, 1992. Interest payments stopped when the IPTF fell to a certain defined level).

[10] *Id.* ch. 89-188, §4, codified at FLA. STAT. §376.3071(12)(i) (1995) ("[p]ayments [of applications for reimbursement] shall be made in the order in which the department receives completed applications").

[11] *See id.* ch. 87-374, §3.

[12] For a more detailed background of the programs see REVIEW OF PETROLEUM STORAGE TANKS CLEANUP REIMBURSEMENT PROGRAM AND EVALUATION OF THE USE OF RISK ASSESSMENT PRINCIPLES IN DETERMINING CLEANUP CRITERIA, STAFF OF THE FLORIDA HOUSE OF REPRESENTATIVES COMMITTEE ON NATURAL RESOURCES, 1-38 (Nov. 1994). *See also* FINAL REPORTS OF THE FLORIDA PETROLEUM TASK FORCE §9.0, FLORIDA DEPARTMENT OF ENVIRONMENTAL PROTECTION (prepared for Secretary Virginia Wetherell) (Dec. 20, 1994).

[13] FLA. STAT. §376.3072.

[14] *Id.* §376.305(7).

[15] *Id.* §376.305(6).

[16] HOUSE BILL ANALYSIS, *supra* note 5, at 3.

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] Eleventh Statewide Grand Jury, filed on March 23, 1994, entitled, "Interim Report Number Two of the Eleventh Statewide Grand Jury"; *see also* Bill Moss, *Comptroller Blasts Tanks Cleanup Plan*, ST. PETERSBURG TIMES, May 3, 1994; Moss, *Cleanup Program Suspended*, ST. PETERSBURG TIMES, March 9, 1995.

[21] Fla. Laws ch. 95-2.

[22] Preceding the bill was an executive order signed by Gov. Lawton Chiles on March 8, 1995, that suspended processing of reimbursement applications for work on all eligible sites. Executive Order No. 95-82, March 8, 1995. This order was rescinded following the passage of ch. 95-2.

[23] The effects of the moratorium bill were far-reaching. Persons conducting work at lower-ranked sites were no longer eligible for reimbursement, although owners could apply for reimbursement of past costs. Fla. Laws ch. 95-2, §2.

The bill also hurt persons conducting work at mid-priority sites. These persons could complete only the pre-remediation program task being performed (initial remedial action, contamination assessment report, or remedial action plan), and could thereafter submit an application for reimbursement. If a remedial action program task (*e.g.*, pump and treat) were being conducted at such a site, this task was to stop until the department granted approval. *Id.*

[24] Fla. Laws ch. 95-2, §2.

[25] For a more complete discussion of the 1995 Session's efforts regarding the tanks program, see Samuel J. Morley, *Florida's 1995 Petroleum Contamination Reimbursement Legislation: Many Questions Left Unresolved*, FLA. BAR ENVIRONMENTAL AND LAND

USE SECTION REPORTER, Vol. XVI, No. 4 (July 1995).

[26] *See* Kathleen Laufenberg, *Tanks Bill Debacle Slams Some Enviro Firms, Labs*, FLA. ENVIRONMENTS (Aug. 1995).

[27] *See* Cyril T. Zameski, *State Tax Money for Fuel Cleanup Running Dry*, THE MIAMI HERALD, July 5, 1995; Dave Newport, *Lawmakers Set to Pass Biggest Tanks Bill Ever* (hereinafter *Set to Pass*), FLORIDA ENVIRONMENTS at 6 (April 1996).

[28] *See, e.g.*, DEP MEMORANDUM: TRANSITION FROM REIMBURSEMENT TO PRE-APPROVED PRIORITY CLEANUP PURSUANT TO CHAPTER 95-2, LAWS OF FLORIDA (June 1995).

[29] See June 12, 1995, letter from R. Dale Patchett (Department) to Rep. Joseph R. Mackey.

[30] *See* HOUSE BILL ANALYSIS, *supra* note 5, at 12.

[31] FLA. STAT. §376.3075.

[32] *Id.* §376.3071(12)(h). Although a monetary blow to contractors, the pay-out schedule is a mere remnant of the original drastic discount provisions imposed under last year's proviso to the appropriations bill. *See* CONFERENCE COMMITTEE REPORT ON SENATE BILL 2800, §5, Specific Appropriation 1337B. That proviso language was challenged by the department and later held unconstitutional and expunged pursuant to a stipulated final order. *Wetherell v. Milligan*, Fla. 2d Cir. Case No. 95-9571, Dec. 13, 1995.

[33] *See* Prakash Gandhi, *Lawmakers Hope New Tank Bill Revives Program*, FLORIDA SPECIFIER at 16 (June 1996).

[34] FLA. STAT. §376.30711(1)(a). The department is now specifically authorized to modify the priority status of a rehabilitation site after taking into consideration the actual distance to groundwater or surface water receptors. *Id.* §376.3071(5)(a).

[35] *Id.* §376.30711(2)(a). The department is required to conduct a pilot project to determine the effectiveness of utilizing competitive bid procedures for procuring the services necessary to perform site rehabilitation. Thereafter, the department is to submit a report by March 1, 1997, with recommendations. *Id.* §376.30711(7).

[36] *Id.* §376.30711(2)(b).

[37] *Id.* §376.30711(5)(b),(e).

[38] *Id.* §376.30711(4).

[39] *Id.* §376.3071(12).

[40] For a discussion of the use of RBCA, see Robert W. Wells, Jr., *Without "Rebecca," Cost-Effective Environmental Cleanup Is an Oxymoron at Florida's Petroleum Contamination Sites*, 70 FLA. B.J. 53 (Feb. 1996); see also FLORIDA'S PETROLEUM UNDERGROUND STORAGE TANKS PROGRAMS, INTERIM PROJECT REPORT, STAFF OF THE FLORIDA HOUSE OF REPRESENTATIVES COMMITTEE ON NATURAL RESOURCES (Nov. 1995).

[41] *See* Dave Newport, *Tanks Program Ripped Apart*, FLORIDA ENVIRONMENTS at 25 (June 1995).

[42] FLA. STAT. §376.3071(5)(b)1-9.

[43] *Id.* §376.3071(5)(b)2.

[44] *Id.*

[45] *Id.*

[46] *Id.* §376.3071(5)(b)7,8.

[47] Workshop Draft, FLA. ADMIN. CODE r. 62-770, Docket No. 96-45R, Oct. 16, 1996.

[48] Proposed FLA. ADMIN. CODE r. 62-770.680 (pp. 56-62), r. 62-770.690 (pp. 62-69).

[49] *See* HOUSE BILL ANALYSIS, *supra* note 5, at 10.

[50] *See Set to Pass, supra* note 27, at 6.

[51] FLA. STAT. §376.3071(13).

[52] *Id.* §376.3071(13)(c).

[53] *Id.* §376.305(6)(b).

[54] *Id.* §376.3072(3).

[55] *Id.* §376.305(6)(b).

[56] *Id.* §376.305(6)(1995).

[57] *See Set to Pass, supra* note 27, at 6.

[58] FLA. STAT. §376.30713.

[59] *Id.* §376.30713(2)(a)1.

[60] *Id.* §376.30713(2)(b).

[61] *Id.* §376.30713(4).

[62] *Id.* §376.3071(11)(a).

[63] *Id.* §376.3071(11)(b).

[64] *Id.* §376.308(5).

[65] *Id.* §376.3078(3).

[66] For a full discussion of the 1994 Drycleaning Act, see Michael R. Goldstein, *Riding the Solvents Sea of Dry Cleaners: How the Environment, the Economy and the Citizens of Florida Have Been Disserved by House Bill 2817*, 69 FLA. B.J. 5 (May 1995).

[67] *See Metropolitan Dade County v. Gottlieb*, 1995 WL 723164 (Fla. 11th Cir. Ct.) (holding that Dade County's complaint should be dismissed if landowner/defendant is eligible or has remediated its property under the drycleaning act pursuant to the immunity contained in §376.3078(3)).

[68] FLA. STAT. §376.308(5).

Preliminary Considerations When Responding to an SEC Enforcement Subpoena

by Gary Langan Goodenow

The U.S. Securities and Exchange Commission is the federal government agency to which Congress has given the mandate of enforcing the federal securities laws. The mandate includes enforcement of the federal anti-fraud provisions: §17(a) of the Securities Act of 1933 and §10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder.

In recent years, the SEC greatly increased its enforcement resources in Florida. The SEC's former branch office in Miami, a branch of the Atlanta Region, is now the Miami Regional Office, and Atlanta is the branch. With an enlarged staff of enforcement attorneys, more investigations and prosecutions for securities laws violations are likely. This article reviews the preliminary considerations for what is typically a client's initial contact with staff: receipt of a subpoena compelling oral testimony and document production.

The Subpoena Package

If needed to testify, the staff sends to a witness a package by registered mail. The package typically contains: 1) a subpoena for testimony at the Commission's offices, scheduled on a date in the ensuing seven days to two weeks; 2) an attachment to the subpoena listing documents the witness must produce at testimony; 3) a four-paged, single-spaced Commission Form 1662, containing serious cautionary warnings;[1] and 4) a courtesy cover letter signed by a staff attorney (collectively, the "package").

Initial analysis for your client should center on what receipt of a package *does not mean*. The package is not, as some believe, the Commission's version of a U.S. Attorney's Office "target letter." If asked if there are "targets," the staff will stress that Commission investigations are "fact gathering inquiries," without "targets."[2] While this may sound glib, it is truly unknown in any investigation who, if anyone, will be sued by the Commission, until the Commission decides the issue based on the staff's written report of the facts. Except in emergency actions, where issuance of a Commission (as opposed to federal court) subpoena is rare, the staff's recommendation to the Commission, if any, is many months, and possibly years away, from the time when a package is sent out.

Following an investigation, the Commission may take enforcement action against everyone who testified in an investigation, or against no one who testified. There are no hard and fast rules with which to advise your client. Accordingly, your client must proceed in the client's own self interest, aware that a Commission enforcement action is possible but by no means certain.

In Florida, the subpoena will list as location for testimony the Commission office in Miami.[3] Testimony location is not subject to negotiation. The Commission retains a court reporter under government contract to transcribe testimony, and these reporters work at Commission offices.[4] If a witness is mortally ill and cannot be moved, the staff, of course, will consider relocation. But the give-and-take negotiations about location that occasion routine deposition scheduling are unknown to Commission practice.

If the amount of documents involved in a response is large, the staff may consider some accommodation, but typically the staff expects all documents to be produced at Commission offices. Owing to that, it is never appropriate to respond to a Commission document demand by stating that the documents are available for inspection and copying at some location. While this may be standard practice in some state courts, such a statement would be considered unresponsive to a Commission subpoena.

The staff is amenable to accepting copies of documents, *if the Commission*

Art by Joe McFadden

does not pay for copying. Under no circumstances should you have your client's documents copied, and then send the invoice to the Commission. The invoice will not be paid. If you send the Commission the originals of requested documents, you bear the risk of their loss. The best practice is to ask the staff if they will accept copies, with the client's keeping the originals. If there is an agreement to this production, memorialize it in writing.[5]

The date and time for testimony is usually negotiable, within reasonable parameters, depending on the facts and circumstances of each case. The staff is receptive to reasonable adjustments of date and time, if they sense that you and your client are being "co-operative." The term "co-operative" is a term of art in Commission practice. By "co-operative," it does not mean that you need to waive all of your client's rights or decline to assert your client's lack of liability for wrongdoing. Being "co-operative" in Commission parlance means that you are working to facilitate the testimony being given as soon as reasonably practicable. The worst image to convey to a staff attorney, or—even worse—to his or her supervisors, is that you seek to control the terms under which your client will testify. Commission attorneys are expected by their supervisors to organize and administer an investigation's progress toward a successful discharge of the Commission's mission. If counsel is perceived, rightly or wrongly, as trying to control the investigation, the staff will acquiesce less and less in requests for accommodation, and any appeal of their lack of acquiescence to their supervisors at the Commission in Washington will almost always fall on deaf ears.

One way to indicate co-operation to the staff is to state that irrespective of when the actual testimony will occur, you are willing to produce copies of the requested documents by a date and time certain. Typically, the staff is receptive to accepting documents for review prior to going on the record. This readiness may be indicated in the cover letter that accompanies the package.

The subpoena attachment listing the requested documents should be read broadly. It is likely that the witness will be producing everything in his or her possession, custody, or control that is at all connected, even tangentially, to the matter under investigation. Interpreting the document demand narrowly, so as to exclude documents by selective interpretation of the attachment, is bad advice and done at your client's peril. In recent years, it has become easier for the staff, upon a perceived lack of "co-operation," to institute subpoena enforcement actions in federal court. Enforcement action is not the way to build credibility with the agency, especially where it is in your client's interest to have the staff believe and understand the client's version of the facts.

The date and time for testimony is usually negotiable, within reasonable parameters, depending on the facts and circumstances of each case

Review Form 1662 with your client prior to testimony. Early in testimony, you can expect Form 1662 will be made an exhibit. The witness will then be asked if he or she has read Form 1662 and understands it.

Far too often, this inquiry from the staff comes as a total surprise to the witness, who as a result is very disconcerted, feeling ill-prepared for testimony. A witness will often then begin perusing Form 1662 in response to the staff inquiry, and be put off balance by the gravity of the cautionary warnings in it. These warnings state: 1) penalties for perjury,[6] 2) sanctions for falsifying requested information,[7] and 3) what are termed the "routine uses" of supplied information, which include making it available to criminal law enforcement agencies, both federal and state. Form 1662's warnings are simply written. Prior to testimony, review of the form with a client will lessen the client's understandable concern about the warnings.

The Formal Order

If the SEC sent your client a package, the Commission has issued a "Formal Order of Investigation Designating Officers to Take Testimony," known in staff terms as a "formal order." The formal order delegates Commission authority to members of the staff to take testimony and review the produced documents. Testimony is technically before the Commission itself, albeit received through staff.

Counsel should request a copy of the formal order. To make a request, review the package for reference to the title of the investigation. It typically appears as: "In the Matter of XYZ." A number usually appears after the investigation title. In Florida, the Commission staff uses "A-dash" numbers, as in A-1900. The number in A-1900 means the 1,900th formal investigation opened in the Atlanta (now Miami) region. More properly, it should be an "M-dash" number, but the nomenclature has not been changed to reflect elevation of Miami to regional status and demotion of Atlanta to branch status. The "HO-dash" (*e.g.*, HO-1900) indicates an investigation initiated in the Commission's "home office," *i.e.*, Washington.

A formal order request is properly addressed to the Commission's local regional administrator. Requests are routinely granted, usually in two weeks. A copy of the formal order will come by mail, along with a cover letter signed by the regional director likely stating the copy is provided for counsel and client only. Not stated is that there is nothing to prevent counsel, except for loss of goodwill with the staff, from sharing the formal order with others. That said, it is hard to imagine circumstances where it would be in a client's interest to publish the formal order.

Formal orders are issued almost reflexively by the Commission upon staff request. Their issuance should not be interpreted that the staff has found incontrovertible evidence of wrongdoing. A formal order means the staff learned facts in which they have placed sufficient stock, after a preliminary review, to concentrate scarce investigative resources on the subject of the formal order. Such resource concentration is made at the expense of other enforcement matters. The staff has more than enough work, especially in Florida, and so it must triage its caseload to decide those matters which merit the attention of limited resources. In most investigations where a formal order is issued, particularly in Florida, a rule of thumb

is that it is likely there will be some kind of enforcement action. But enforcement action is not the case in all investigations, and rarely is there enforcement action against everyone investigated in any one matter.

Like most Commission documents, formal orders are based on an approved form developed over years of practice. They contain the title of the investigation, usually with a proper noun, but sometimes with a broader name like "In the Matter of Certain Foreign Issuers." Some attorneys believe that if their client's name is not in the formal order title, the client will not be sued following the investigation. This folklore comes from years ago when it was staff practice to put in the investigation title the names of any person who conceivably might be named as a defendant, a practice now abandoned.

Conversely, the formal order title does not mean that the staff is limited in its investigation to matters that only touch the names. The staff's power to take testimony is broad, and if they can develop evidence about another matter from a witness during testimony, the staff will do so.[8]

Staff practice is for formal orders to contain lengthy lists of persons who are designated by the formal order with authority from the Commission to take testimony and require document production. Some attorneys have mistakenly advised their clients that this long list of names reveals that the Commission is putting enormous resources into the investigation, and that this is an ominous sign. This advice is incorrect. The Commission staff routinely puts in the formal order the name of almost every attorney employed at the office involved. This is not because every attorney is assigned to the matter, but because staff turnover makes it frequently necessary to reassign cases. The staff seeks authority under the formal order delegated to as many persons as possible, so they do not have to ask the Commission to amend the formal order if the staffing needs change. Most likely, when a witness appears to testify, the session will be administered by the staff attorney who signed the cover letter in the package.

In Miami, the Commission basically has two legal groups: three litigation attorneys dedicated to prosecuting filed cases, and a much larger staff of enforcement attorneys who are titled "staff attorney," "senior enforcement attorney," or "senior counsel." These titles have more meaning within the Commission than without. The titles offer no insight into the priority of the investigation for the staff, nor the level of talent or experience brought to bear on it. That said, if an investigation seems driven by a staff litigation attorney, their relatively early inclusion likely means the staff is contemplating emergency relief, without an investigation by formal order. Beyond this observation, there is little to offer your client in terms of insight based on the title of the attorney involved.

Toward Testimony Day

Prior to testimony, the staff may inquire as to who else will be present at testimony, besides the witness and the witness' counsel. Almost universally, the witness and counsel are the only persons allowed at testimony. Very often, there will be two persons appearing on behalf of the Commission. If one is a staff accountant, this is plainly a clue as to the focus of the staff's investigation.

In extraordinary matters, the staff will allow what are termed "technical advisors" to attend testimony, but this is the exception and not the rule.[9] The allowance applies only to advisors for the witness' counsel, as *e.g.*, a geologist in an oil-and-gas case. A technical advisor is present so the witness' counsel can make sense from questions that concern matters so technical as to be typically outside counsel's understanding. Contrary to the view of some, staff allowance for attendance of "technical advisors" is not an opportunity for others represented by the same counsel to watch the testimony. One cannot simply designate a person as a "technical advisor," and ask them to take a seat at the testimony. If such an effort is made, the staff would doubtlessly adjourn the testimony and consider that the compelled witness failed to respond properly.

Strictures also apply to attendance by counsel for other witnesses. Some attorneys, based on civil practice, expect that once they have appeared with a client for Commission testimony, they may attend the testimony of other witnesses. They may even ask at the conclusion of their client's testimony to be

put on the "certificate of service list." Such requests are not granted in Commission practice.[10]

The only circumstance where one attorney may attend testimony by different witnesses is where he or she represents several witnesses in the same investigation. The practice of one attorney representing several witnesses is viewed skeptically by the staff. If the staff can show "concrete evidence" that multiple representation will impede the investigation, they can disallow an attorney from appearing.[11] Such a showing is very hard, absent a witness waiving attorney-client privilege and revealing secret plans for coordination of testimony. Attorneys should know that in cases of multiple representation by same counsel, the staff, at the very least, may *suspect* that there has been coordination of testimony between witnesses. This suspicion is only natural but it weighs against a witness' credibility. In the view of some staff, testimony under such circumstances lacks the conviction present if there were different attorneys for each witness and the witnesses' stories matched. For ethical reasons, those who plan to represent more than one witness should disclose and discuss these considerations with their clients. Most importantly, *nothing* destroys counsel's credibility with the staff more than if he or she accompanies a witness who gives testimony, and then the witness returns at a later date with new legal counsel, and changes testimony in a material way.

In preparation for testimony, the temptation is to view it as simply testifying at deposition. There are many differences, but two that should be considered at the threshold are the law on privileges and the opportunity for a closing statement and questions.

Privileges

The most important decision for a witness to make prior to Commission testimony is whether to invoke the Fifth Amendment protection against self- incrimination. Almost every statute and rule the Commission enforces by civil action have criminal law counterparts enforced by the Department of Justice. Accordingly, the client must be well-advised with respect to "taking the Fifth." Some staff attorneys will even ask witness' counsel prior to testimony if the witness intends to make a Fifth Amendment claim. There is nothing sinister about this question: Anticipating such a claim merely reduces the preparation the staff needs to make for testimony. The staff's question is not an indication staff thinks one way or another as to whether a witness should or should not "take the Fifth."

If the witness takes the Fifth, expect the staff will then read into the record cautionary warnings, the most important of which states: The staff cannot grant immunity from criminal prosecution. Any answers made by the witness after such a warning must be made voluntarily and not in an expectation of immunity. After the warnings, typical practice is for the staff to ask the witness three or four leading questions about a matter involved in the investigation. After the witness asserts the Fifth in response to each question, the staff will then ask if the witness will continue to assert the Fifth if the staff asks any further questions about the matter. Predictably, the answer is either a "yes" or another assertion of the Fifth. The staff then moves on to another matter, for another three or four questions. By such a process, the staff is building a record to take a negative inference against the witness if an enforcement action is later authorized against the witness.[12] If your client intends to take the Fifth, and there are compelling reasons to do so discussed outside of this article, the client must be prepared for such questioning by the Commission. Nothing is more bewildering to a witness than to undergo this seemingly meaningless repetition of the Fifth Amendment privilege, if the witness does not know beforehand the reasons for it.

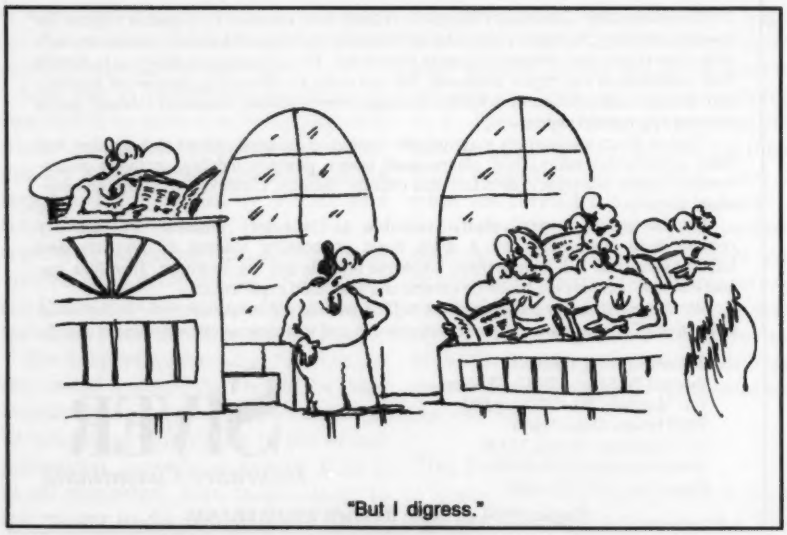
The attorney-client and work-product privileges apply to Commission testimony. If invoked, the witness should be prepared to be questioned, at length, regarding elements of the privileges. The Commission staff is usually not satisfied with a simple assertion of either privilege, and wants the facts forming the basis of the privilege stated in the record.[13] This is especially true with respect to facts that may show a legal basis for the staff to argue later that the privilege was waived.

As to other assertions of privilege, the client who has been well-briefed by his or her counsel will be aware that the Commission does not recognize the following privileges: accountant-client,[14] broker-customer,[15] banker-depositor,[16] and physician-patient.[17] Such communications are all fair game for Commission investigation. This includes testimony by the witness' tax preparer.[18]

The Closing Statement

Staff concludes testimony by inviting the witness to clarify any statements he or she might have made. In addition, the staff will invite witness' counsel to ask any clarifying questions for the record. This is an opportunity that is sometimes ignored: In many instances, the witness and counsel decline these offers because they fail to discuss the matter beforehand.

Within reasonable boundaries of time, staff gives an opportunity for concise presentation of the witness' view



"But I digress."

of events. By closing statements, witnesses have successfully proffered an explanation to the staff ultimately resulting in the staff's not recommending enforcement action against the witness. If there is a concise explanation of events that has not come out by direct examination, counsel should ask questions to reveal it. It is not recommended that counsel simply forebear the opportunity because they feel they can later do so in a "Wells Submission."[19] A "Wells" is a written submission by a person, typically one who has given testimony, made to the staff, which accompanies the staff's written recommendation to the Commission *for enforcement action against the person!* By then, the staff's view of the person's culpability is harder to change than at testimony. And submitting a Wells Submission is not a matter of right. If the witness has a credible explanation to offer, it is best to offer it early.

Conclusion

Practice before the Commission with respect to witness testimony is not beyond the scope of the nonspecialist practitioner, if the ground rules are known and understood, and the witness is well-prepared. ❑

[1] The full title is "Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a Commission Subpoena," SEC Form 1662 (6/96).

[2] *SEC v. O'Brien*, 467 U.S. 735 (1984).

[3] Presently, the Commission's offices are on the second floor of 1401 Brickell Avenue, Miami, Florida. Parking is in the rear of the building.

[4] Rule 6 of the Commission's Rules of Practice provide that a witness may purchase a copy of his or her transcript. Counsel should ask the staff for the proper form to make the request. The cost is usually high, typically several dollars per page. *See generally* 17 C.F.R. 203.6.

[5] The staff views photocopying as being an accommodation for the witness' convenience, not the staff's. Accordingly, the staff will not agree to reimbursement of copying charges. *See SEC v. Arthur Young & Co.*, 584 F.2d 1018 (D.C. Cir. 1978).

[6] *See* 18 U.S.C. §1621.

[7] *See* 18 U.S.C. §1001.

[8] The formal order's recitals may become more important based on the recent case of *Patricia Johnson v. SEC*, 1996 WL 338395 (D.C. June 21, 1996), where the court found there is a five-year statute of limitations for SEC administrative proceedings. The formal order may indicate the date the conduct occurred.

[9] *See SEC v. Whitman, et al.*, No. 85 Misc. 83 (D.D.C. Sept. 11, 1985).

[10] *See SEC v. Meek*, CCH ¶97,323 (10th Cir. 1980).

[11] *See SEC v. Csapo*, 533 F.2d 7, 11 (D.D.C. 1976).

[12] *See SEC v. Scott*, 565 F. Supp. 1513 (S.D. N.Y. 1983); *SEC v. Musella*, 578 F. Supp. 425 (S.D. N.Y. 1984).

[13] *See SEC v. Kingsley*, 510 F. Supp. 561 (D.D.C. 1981).

[14] *See U.S. v. Arthur Young & Co.*, ___ U.S. ___, 104 S. Ct. 1495 (1984).

[15] *See McMann v. SEC*, 87 F.2d 377 (2d Cir. 1937).

[16] *See U.S. v. Miller*, 425 U.S. 435 (1975); see also the Right to Financial Privacy Act of 1978 for special projections that may apply.

[17] *See U.S. v. Meagher*, 531 F.2d 752 (5th Cir. 1976).

[18] *See* 26 C.F.R. 301 as to 26 U.S.C. §7216.

[19] See Securities Act Release Number 5310 (Sept. 27, 1972) for a description of a "Wells Submission," named for the chair of a reform committee that recommended the concept.

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Closing Protection Letters

by Shawn G. Rader

In order to meet the concerns of lenders with regard to the liability of a title underwriter for the escrow and closing activities of its approved attorneys or corporate agents, title underwriters offer upon request "insured closing letters" or "closing protection letters." These letters outline the conditions under which the title underwriter will accept liability for the acts or omissions of its agents. Their use became common enough that in 1987 the American Land Title Association developed a standard form closing protection letter.[1]

Closing protection letters indemnify lenders against damages arising out of certain claims which they may have against the agent of the title insurance company when a policy is to be issued, including protection against fraud and dishonesty of the issuing agent or approved attorney in handling the lenders' funds or documents in connection with a closing. In addition, the ALTA form (and most closing protection letters issued) offer the same protection to the borrower for loans secured by a mortgage on a one- to four-family dwelling.

The purpose of this article is to review how the courts have looked at and interpreted closing protection letters over the past 25 years. The cases will be grouped into three categories: 1) closing protection letters as insurance; 2) coverage and use of closing protection letters; and 3) closing protection letters and agency.

In many instances, the closing protection letter affords valuable coverage, at least with regard to the funds coming from the lender at closing

Closing Protection Letters as Insurance

Does a closing protection letter constitute insurance? In the case of *Metmor Financial, Inc. v. Commonwealth Land Title Insurance Company*, 645 So. 2d 295 (Ala. 1993), an attorney closing agent failed to ensure that a house purchased came with a 10-year warranty as required by Metmor, the lender. Metmor sued Commonwealth Land Title Insurance Company for bad faith based on the closing protection letter it had received from Commonwealth. The Supreme Court of Alabama upheld the lower court in granting a summary judgment in favor of Commonwealth, holding that the only breach of contract actions in which a bad faith cause of action will lie are those involving insurance contracts. Closing protection letters are not insurance contracts, because no premium is collected for their issuance; thus, no cause of action for bad faith could be maintained against Commonwealth. In short, Alabama holds that a closing protection letter is not insurance as it is defined in Alabama.

The only Florida case to wrestle with the issue is *Escrow Disbursement Insurance Agency, Inc. v. American Title and Insurance Company, Inc.*, 550 F. Supp. 1192 (S.D. Fla. 1982). This is an interesting case in which a company that was in the business of selling "gap insurance" sued a host of title underwriters under the Sherman Act for monopoly. The suit was filed in 1976; the reported case deals with a motion six years later to reinstate the count for monopoly which had been previously dismissed. The title underwriters argued against it, pointing out that since the 1940s, title insurance companies had been offering protection for the gap through the use of "insured closing service letters."[2] The underwriters also argued that the McCarran-Ferguson Act exempted the business of insurance regulated by state law from the Sherman Act. In ordering the reinstatement of the monopoly count, the court, among other holdings, held that closing protection letters might not meet the definition of "insurance" under the McCarran Act because the letters do not spread risk, and the spreading of risk is an integral part of insurance. (The gap insurance company was already out of business by the time of the 1982 decision. This author has been informed that the Federal Trade Commission became involved and accepted as settlement a $10,000 fine against each defendant title underwriter.)

Escrow Disbursement Insurance Agency would seem to put Florida in the Alabama column with regard to whether closing protection letters are insurance; however, in at least two Florida circuit court decisions the judges have ruled that closing protection letters were a form of insurance, therefore entitling the plaintiff insureds to the recovery of attorneys'

fees in their suits against title underwriters (for claims arising under closing protection letters and not the policies). The circuit courts relied upon the Florida Insurance Commissioner's promulgating the form of closing protection letters to be used in this state. In addition, F.S. §627.786 (1995) reads as follows:

627.786 Transaction of title insurance and any other kind of insurance prohibited.

(1) An insurer may not transact title insurance and any other kind of insurance in this state.

(3) Subsection (1) does not preclude a title insurer from providing instruments to any prospective insured, in the form and content approved by the department, under which the title insurer assumes liability for loss due to the fraud of, dishonesty of, misappropriation of funds by, or failure to comply with written closing instructions by, its contract agents' approved attorneys in connection with a real property transaction for which the title insurer is to issue a title insurance policy or guarantee of title.

Subsection (3) seems to imply that closing protection letters are "any other kind of insurance" as mentioned in subsection (1); otherwise, subsection (3) would be unnecessary.[3]

Three other cases dealing with this issue all resolve it by holding that the closing protection letter is in fact integrated into the title policy and a part thereof. This worked in favor of Chicago Title Insurance Company in the case of *Fleet Mortgage Corporation v. Lynts*, 885 F. Supp. 1187 (E.D. Wis. 1995), wherein Chicago Title wanted the arbitration clause in the title policy applied to a suit based on a claim under a closing protection letter in which it was a defendant. In holding that the closing protection letter was incident to the issuance of title insurance, the court stated as follows:

Beyond the general recognition that the closing letters are concomitant with the issuance of title insurance policies, there is another important factor: Fleet paid no extra consideration for the closing letters. As a business, it is highly unlikely that Chicago Title, or any other title insurance company, would provide closing letter indemnification out of the goodness of its heart. If the closing letters were a "separate contract" as Fleet urges, it would be very peculiar for Chicago Title to get such a promise without something in return. Furthermore, if the promise was considered a separate contract unsupported by consideration, Fleet would be in a worse position because such a gratuitous promise is unenforceable.

Id. at 1190.

The New Jersey Supreme Court has also reached the same conclusion in two companion cases: *Clients' Security Fund of the Bar of New Jersey v. Security Title and Guaranty Company*, 634 A.2d 90 (N.J. 1993); and *Sears Mortgage Corporation v. Rose*, 634 A.2d 74 (N.J. 1993).

Examples of Coverage/Use of Closing Protection Letters

In *Herget National Bank of Pekin v. USLife Title Insurance Company of New York*, 809 F.2d 413 (7th Cir. 1987), a group of banks together participated in the funding of a construction project. USLife gave closing protection letters to the banks as to its agent, which was holding all of the banks' funds in escrow and would disburse them. The agent was a wholly owned subsidiary of the developer that had put the package together and enticed the banks to participate by making construction loans. The developer made a representation to the banks that the Government National Mortgage Association (GNMA) would provide a take-out loan, but after the funds were disbursed, the banks learned that the GNMA had never made a commitment for permanent financing. The banks sued the developer, and later settled the litigation. Then to secure substitute permanent financing of the project to replace the construction loans, the banks arranged for the sale of industrial revenue bonds. The sale of the bonds was successful, and the banks recovered all of their investments plus interest. Nevertheless, they brought suit against USLife claiming that they had also incurred substantial loss of income that they would have earned had the money been repaid by the end of the originally contemplated contract period instead of the five years that it had actually taken for the loans to be repaid. They also claimed that they had incurred significant attorneys' fees and related expenses throughout the process. In its insured closing service letter, USLife agreed to "reimburse [the Banks] for any loss of your settlement funds transmitted by you to [our issuing agent] where loss results from their fraud or dishonesty." (*Id.* at 416.) Consequently, both the district court and the Seventh Circuit Court of Appeals agreed that the coverage against the loss of those funds did not include

damages sustained by the payment of attorneys' fees, expenses incurred in connection with bringing the loan to closing, or indirect losses such as a loss of profits. The language in the closing protection letter referred to only those funds actually transmitted by the banks to the title company.

The situation was similar in *First Financial Savings & Loan Association v. Title Insurance Company of Minnesota*, 557 F. Supp. 654 (N.D. Ga. 1982). In this case, Heritage National Mortgage Corporation received a closing protection letter from Minnesota Title. There were two separate closings, and for each, Heritage sent a draft. The two closings took place with the closing attorneys informing Heritage that the closings were conditional on the drafts being funded. Immediately following the respective closings, and by an assignment instrument dated the same day as each closing, Heritage sold both loan packages to the plaintiff, First Financial, for a slightly discounted amount. First Financial wired Heritage approximately $48,000 as the purchase price. Meanwhile, Heritage's drafts had been presented for payment by the closing attorneys and had been dishonored. As a result, the closing attorneys neither recorded any of the closing instruments, nor paid the prior existing mortgages of record. First Financial then brought suit against Minnesota Title claiming it had a right to recover under the closing protection letter furnished to Heritage. Minnesota Title argued that because Heritage had never provided the closing attorneys with good settlement funds, there was clearly never any loss of such funds and thus no loss compensable under the closing protection letter. The court granted summary judgment in favor of Minnesota Title on the issue.[4]

Closing Protection Letters and Agency

In many situations, the title underwriter has an established agency agreement with its corporate agency or a law firm. When the latter are handling a closing in which the title underwriter's policy is being issued, the furnishing of a closing protection letter by the title underwriter is superfluous in terms of designating the closing agent as an "agent" of the underwriter. On the other hand, it frequently occurs that the title underwriter has no relationship with the closing attorney who has been designated by either the borrower or the lender. Also, there are situations where the title underwriter has an agency agreement with the closing attorney or agency, but the agreement specifically excludes closing and escrow activities. When a claim arises under a closing protection letter in these circumstances, how have the courts ruled?

There are situations where the title underwriter has an agency agreement with the closing attorney or agency, but the agreement specifically excludes closing and escrow activities

Starting first with the last situation, in the case of *Lawyers Title Insurance Corporation v. Dearborn Title Corporation*, 904 F. Supp. 818 (N.D. Ill. 1995), Lawyers Title had an agency agreement with Dearborn Title, but the agreement specifically excluded any escrow or closing activities on the part of Dearborn. In connection with closings handled by Dearborn, Lawyers Title issued closing protection letters to lenders and was forced eventually to fund $5 million as a result of Dearborn Title's defalcation. Lawyers Title then sued Dearborn Title for the loss and also sued First Midwest Bank which held the escrow accounts for Dearborn Title. Lawyers Title claimed First Midwest Bank had knowingly used escrow account funds to satisfy debts owed to it by Dearborn Title. First Midwest Bank counterclaimed, alleging that Lawyers Title had violated the Illinois Title Insurance Act by misrepresenting the terms and conditions of the closing protection letters because one receiving such a letter would naturally assume that Dearborn Title was an escrow agent of Lawyers Title. Lawyers Title moved to dismiss the counterclaim, but the court refused, saying the allegations were sufficient that the insured failed to explain to customers that the agent's activities in its capacity as escrow agent were not within the scope of an agency relationship between the agent and title underwriter. Thus the agency issue arose, albeit Lawyers Title did not contest its liability for making good on the escrow funds under the terms of the closing protection letter.

TRW took a different tack in *Coldwell Banker Relocation Services, Inc. v. TRW Title Insurance Company*, 74 F.3d 1243 (Table—unpublished disposition, 1996 W.L. 5156 (8th Cir. 1986)). In this case, TRW had an agency agreement with the closing attorney which specified that he was an agent for the issuance of title insurance, but not for escrow services performed during closings at real estate transactions. In connection with some closings held for Coldwell Banker, the agent stole the funds from an escrow account rather than using them to retire prior mortgages. Coldwell Banker paid off the prior mortgages and then brought suit against TRW. TRW denied liability based on its agency agreement. It had issued an insured closing protection letter to the lender, but claimed that it had cancelled it before the closing. Based on the issuance of the letter, however, and based on its finding that the attorney had implied authority to act as TRW's agent during the closing, the court found TRW liable for the loss incurred by Coldwell Banker as a result of the theft. The closing protection letter was sufficient to establish agency notwithstanding the agency agreement upon which TRW wanted to rely.[5]

Two New Jersey cases analyzed the extent of a title underwriter's liability in a situation where the closing agent stole the escrow funds intended to pay off prior mortgages, and the title commitment made the payoff of the prior mortgages one of its requirements. Closing protection letters are discussed in both cases, although in one case they were issued, and in the other case they were not issued. Agency played a role in both.

In *Sears Mortgage Corporation v. Rose*, 607 A.2d 1327 (N.J. App. 1992), the buyer's attorney was the closing agent. Commonwealth Title issued a title commitment which required that the prior mortgage held by Sears Mortgage Corporation be paid off at closing. No closing protection letter was issued. The buyer's attorney remitted the pre-

mium for the policy to Commonwealth, but he kept the funds intended to pay off the Sears mortgage. This fact came to light quickly, and Commonwealth refused to issue a policy without including the Sears mortgage as an exception. The buyer refused to accept such an exception. Sears brought a foreclosure action against the buyer and the buyer brought a third party action against Commonwealth. The trial court ruled in favor of the buyer, holding that the buyer's attorney was an agent for Commonwealth. The appellate court reversed the trial court, holding that the buyer's attorney was not an agent of Commonwealth. It pointed out that the buyer chose the attorney, with whom Commonwealth had no prior relationship. In addition, the buyer had endorsed over the closing proceeds to the attorney; therefore, the loss was best lodged with the buyer.

The New Jersey Supreme Court in *Sears Mortgage Corporation v. Rose*, 634 A.2d 74 (N.J. 1993), reversed the appellate court and reinstated the trial court's decision. The Supreme Court held that the buyer's attorney who ordered the title commitment and was an "approved attorney" for Commonwealth was an agent of the title underwriter. Moreover, the Supreme Court stated that the title underwriter was in the best position to prevent the defalcation. It was obviously aware of the possibility by virtue of the fact that as part of its business it issued closing protection letters (even though none was offered in this case). Moreover, the court held that because title underwriters give closing protection letters to lenders, they have a minimum duty of informing a buyer that he or she is not covered by the same protection. As to Common-wealth's argument that in offering the protection to buyers, it would be furnishing buyers with fidelity insurance which it is prohibited from selling in New Jersey, the Supreme Court stated that the furnishing of closing protection letters is an existing practice and one incidental to the issuance of title insurance.[6] Consequently, the Supreme Court ruled Commonwealth had to pay the Sears mortgage and would not be allowed to take an assignment thereof and foreclose against the buyer.

In the case of *Clients' Security Fund of the Bar of New Jersey v. Security Title & Guaranty Company*, 607 A.2d 1319 (N.J. App. 1992), the buyer's attorney handled the closing and pocketed the money which was intended for the payoff of a prior mortgage by Center Savings. Security Title had issued a closing protection letter to the insured new lender, Southern Mortgage Associates. In order to resolve the situation, Security Title purchased the prior Center Savings mortgage and subordinated it to the insured mortgage. Security Title then turned around and brought a foreclosure action of the Center Savings mortgage against the buyer of the property. The buyer sold the property, paid off the insured mortgage, and put the $42,000 of equity in escrow pending the court's decision as to whom should receive it. The court ruled that the buyer's attorney was in fact the lender's agent for closing. It went on to rule that because the money stolen was never supposed to go to the buyer, but instead to pay off the prior mortgage, the stolen funds actually belonged to the lender, whose agent stole them. Therefore, the loss was properly that of the lender. Of course, having issued the closing protection letter, Security Title was liable to the lender for its loss. Because the buyer never got the benefit of the consideration of the lender's proceeds, Security Title would be required to cancel the note and prior mortgage it had bought.

The New Jersey Supreme Court affirmed the decision with some refinement in *Clients' Security Fund of the Bar of New Jersey v. Security Title & Guaranty Company*, 634 A.2d 90 (N.J. 1993). The Supreme Court ruled that Security Title must absorb the loss due to the defalcation. It ruled that title underwriters are in a better position to protect against the danger of defalcation, of which they are obviously aware because of their practice of issuing closing protection letters. The Supreme Court held that the title underwriter could only go against the buyer to the extent that the lender could do so. The defalcating attorney was in fact the lender's attorney; therefore, Security Title could not bring an action against the buyer.[7] Finally, the Supreme Court held that closing protection letters are part of the title insurance policy and therefore fees are awardable for bringing a claim thereunder.

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Conclusion

In Florida, the question as to whether closing protection letters constitute insurance has yet to be answered definitively. In many instances, regardless of its status as insurance, the closing protection letter affords valuable coverage, at least with regard to the funds coming from the lender at closing.

An insured seeking to assert a claim based upon a closing protection letter also has the ex contractu argument of agency, depending on the facts of the case. The holdings of the New Jersey Supreme Court will serve as a guide for making the argument.

As evidenced by the cases and statutes cited in this article, however, the law is far from uniform in its treatment of closing protection letters, a situation which is likely to remain the same for the foreseeable future. ❑

[1] *See* JOYCE D. PALOMAR, TITLE INSURANCE LAW, §5-12 (1994); and Oscar H. Beasley, *Escrows and Closings*, TITLE INSURANCE 1994 (1994).

[2] Before the 1980s, at least in Florida, the use of these letters was not widespread, and they were specific to a designated attorney or agent.

[3] In *Escrow Disbursement Insurance Agency, Inc. v. American Title and Insurance, Inc.*, 551 F. Supp. 302 (S.D. Fla. 1982), the court dealt with a motion in limine by the gap insurer to exclude from evidence at trial a document that was issued in 1978 called the "Bober Report," which was issued by the presiding hearing officer of a nonadversarial public hearing conducted by the Office of the Treasurer, Insurance Commission of the State of Florida. In the case, a hearing was requested by Escrow Disbursement Insurance Agency, Inc., to resolve three issues, the first of which was whether "escrow letters" or "insured closing letters" issued by title insurance companies in the State of Florida were prohibited by FLA. STAT. §627.786. The hearing examiner resolved the issue in favor of the title insurance underwriters. The court, however, granted the motion and held that the report was inadmissible for hearsay and nonhearsay purposes. For additional reading on antitrust policy and title insurers, *see* D. BARLOW BURKE, JR., LAW OF TITLE INSURANCE (1993). Professor Burke has a discussion of the topic in §8.1.

[4] The court cites as precedent its unreported decision in *James T. Barnes Mortgage Company v. Stewart*, C 78-1310A (N.D. Ga., March 30, 1979). *See also Gerrold v. Penn Title Insurance Company*, 637 A.2d 1293 (N.J. App. 1994).

[5] The insured plaintiff in Florida has an easier time because of FLA. STAT. §627.792. (Utah has a similar statute.) The Florida Statute reads as follows:
"A title insurer is liable for the defalcation, conversion, or misappropriation by a licensed title insurance agent of funds held in trust by the agent pursuant to s. 626.8473. If the agent is licensed by two or more title insurers, any liability shall be borne by the insurer upon which a title insurance binder, commitment, policy or title guarantee was issued prior to the illegal act. If no binder, commitment, policy or guarantee was issued, each title insurer represented by the agent at the time of the illegal act shares in the liability in the same proportion that the premium remitted to it by the agent during the one year period before the illegal act bears to the total premium remitted to all title insurers by the agent during the same time period."

[6] The argument was not specious. Both New York and Kansas ban closing protection letters from title insurance companies for that very reason.

[7] For recoupment efforts by title underwriters, *see Lawyers Title Insurance Corporation v. Edmar Construction Company, Inc.*, 294 A.2d 865 (D.C. App. 1972), and *American Title Insurance Company v. Burke & Herbert Bank & Trust Company*, 813 F. Supp. 423 (E.D. Va. 1993).

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This column is submitted on behalf of the Real Property, Probate and Trust Law Section, Robert W. Goldman, chair, and David H. Simmons and Brian Felcoski, editors.

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Objectionable Closing Argument: Causes and Solutions

by Gary D. Fox

This article addresses improper closing argument in response to the following observations recently articulated by appellate judges: "Why the problem [of improper closing argument] persists is an academic question deserving of consideration." *Hammond v. Mulligan*, 667 So. 2d 854 (Fla. 5th DCA 1996). "Clearly, this is an area where training of counsel and of the judiciary is badly needed in order to prevent the waste of judicial resources, the squandering of juror time and effort and the expense of retrial incurred by the litigants." *Olbek v. Kraut*, 650 So. 2d 1138 (Fla. 5th DCA 1995).

All participants in the adversary system can and should commit to conduct which will reduce the waste of judicial and litigants' resources caused by improper closing argument

The Problem

With increasing frequency, trial lawyers are making closing arguments perceived by the trial and appellate courts to be sufficiently pernicious to require new trials. The problem cannot be corrected without identifying the causes.

Lawyer-Created Problems and Proposed Solutions

Lawyers make improper arguments for a variety of reasons, most often 1) lack of knowledge and experience, and 2) lack of preparation. While knowledge flows from experience, those with less experience can learn the rules of closing argument by reading the cases.

A lawyer who accepts the responsibility of trying a case has the affirmative responsibility to clearly understand and follow rules governing closing argument. One of the problems confronted by trial lawyers today is that the rules keep changing. They vary from district to district and even within districts.[1] Nonetheless, there are certain basic tenets that trial lawyers continually violate. Almost every edition of *Florida Law Weekly* contains decisions reversing jury verdicts because of improper argument. A great many lawyers either do not know the law, know it but do not follow it, or know it, intend to follow it but, in the heat of battle, forget the rules and violate them.

Examples of particularly egregious arguments include the plaintiff lawyer telling the jury in *Metropolitan Dade County v. Cifuentes*, 473 So. 2d 297 (Fla. 3d DCA 1985), "I know last night I did not sleep. I know that last night was probably the first time in a long time that I told my wife that I loved her . . . ."[2] In *Martin v. State Farm*, 392 So. 2d 11 (Fla. 5th DCA 1980), a death case involving a child, counsel told the decedent's mother in the course of his closing argument, "You don't buy a boy, as you would on the market . . ." and the jury shouldn't give the plaintiff "lots of money just like we are selling beef. I think that's what he's doing, selling beef. . . but in my heart, and from what I have heard, I believe that your only just verdict can be one for the defendants."[3] In the very recent case of *Donahue v. FPA Corporation*, ___ So. 2d ___, 21 Fla. L. Weekly D 1325 (Fla. 4th DCA June 5, 1996), counsel compared one of the plaintiff's expert witnesses to personal injury lawyers "who advertise on benches 'Call 1-800, you know, sue you, whatever. If you are a lawyer, that's embarrassing.'"[4]

Trial judges can help reduce the incidence of closing arguments like these by including as a part of every order setting a case for trial an unambiguous statement that lawyers who try cases before them will be expected to know and follow the law of closing argument. At case management or pretrial conferences, the trial judge should reiterate these expectations. Another reminder should be given at the charge conference, shortly before the argument is to take place. The court should encourage attorneys to seek pre-argument rulings on proposed statements or arguments which fall into the gray areas.

During the closing argument if the lawyer violates one of the rules, the trial court should warn counsel that if another improper argument is made, it will entertain a motion for mistrial and rule on it after the verdict. Counsel should be advised that if the lawyer's client prevails, it will grant a new trial and assess the opposing party's fees and costs against the lawyer—not against the client or the lawyer's firm, but against the lawyer personally.[5]

The probabilities are slight that a lawyer will continue to make improper argument if, after the first objection, the trial court gives such an admonition. Rarely are isolated statements in

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closing the cause of reversals. A strong cautionary instruction will often prevent repeated improper arguments that violate the rules and thereby eliminate the "cumulative effect" upon which so many new trials are granted.[6]

That lawyers should know the law of closing argument and be held accountable for not following it is not a novel concept. As Judge Blue noted, concurring in *Luce v. State,* 642 So. 2d 642 (Fla. 2d DCA 1994), "If lawyers do not recognize improper argument, they should not be in a courtroom."

Every trial lawyer has the power to give effective, persuasive, and error-proof closing arguments. Experienced trial lawyers know what the evidence will be in the case, both from their side and from the opposing side, months in advance of trial. There is no reason to wait until commencement of the trial or later to prepare the closing argument.

Advance preparation of the closing is not only the best way to stay within the rules but is also an excellent trial preparation technique. Charting out what the jury will be told in closing argument serves as a tool to streamline proof. If a witness or document is not significant enough to be mentioned in closing, the witness shouldn't be called nor the document introduced. Early preparation of closing is an invaluable tool in simplifying the case and reducing the stress and tension associated with the trial of lawsuits.

Jury trials are fatiguing. Trial lawyers don't do their best work when they are tired. Vince Lombardi was correct when he said "fatigue makes cowards of us all." Improper arguments, cheap shots, and flagrantly emotional appeals are adversarial short cuts taken by lawyers who haven't properly prepared their closing.

Judicially Created Problems and Proposed Solutions

Trial lawyers are loathe, for obvious reasons, to criticize published opinions of appellate courts. One cannot, however, honestly discuss solutions to the problems identified by the courts without examining the role in which certain appellate opinions have contributed to the problem.

1) *Fundamental Error*

One such problem is the expansion of the "fundamental error" rule as it applies to closing argument.[7] The fundamental error doctrine presumes that once a particular argument has been made, the jury has been so poisoned that sustaining an objection and giving a curative instruction will be ineffective in erasing the statement from the juror's mind and a mistrial or new trial should be granted.[8] It allows the attorney for the aggrieved party to preserve the argument as error without so much as whispering an objection, requesting a curative instruction, or moving for a mistrial.[9]

Advance preparation of the closing is not only the best way to stay within the rules but is also an excellent trial preparation technique

Some appellate judges "have come to be of the view that a party who does not object to counsel's comments in closing should not be allowed to complain of these comments on appeal. It is anomalous that the more objectionable the comment, the less the incentive to object."[10] Indeed. Yet the rule persists.

The problems created by the fundamental error rule (or the misapplication of it) are exemplified in the recent case of *Baptist Hospital, Inc. v. Rawson,* 674 So. 2d 777 (Fla. 1st DCA 1996), in which the plaintiff's lawyer without objection made "numerous" improper comments during the course of closing argument. The court quotes multiple parts of the plaintiff's closing and found that the argument violated the fundamental error rule because the cumulative effect was "so pervasive as to affect the fairness of the proceeding ...."[11]

What would have happened if, after the first improper argument, an objection had been lodged and the court had read the lawyer the riot act as suggested above? The probabilities are good that no further objectionable arguments would have been made. The effect of allowing counsel to sit idly by and not object is to permit and encourage additional improper argument which, when taken collectively, constitutes fundamental error because of their *cumulative* impact. Thus, the fundamental error rule not only encourages trial lawyer torpor, but also deprives trial judges of an opportunity to intervene, issue appropriate curative instructions and thereby prevent the accumulation of improper arguments in the first instance.[12]

2) *Rule 4-3.4(e)*

The mechanistic and unrealistic applications of Rule 4-3.4(e) of the Rules Regulating The Florida Bar have created additional uncertainties. The rule provides, in relevant part, that trial lawyers shouldn't express personal opinions about "the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused." Appellate courts disagree about 1) what the rule means, 2) how it should be applied, and 3) the appropriate sanction for violating it.[13]

Opinions generated by the same appellate court have sent mixed signals concerning this issue. For example, in *Kaas v. Atlas Chemical Co.,* 623 So. 2d 525, 526 (Fla. 3d DCA 1993), the court held that a lawyer's repeated statements that a witness is a liar fell "squarely within the category of fundamental error." In *Forman v. Wallshein,* 671 So. 2d 872, 873 (Fla. 3d DCA 1996), the court, in a not-too-subtle attempt to recede from *Kaas,* held it is acceptable to call a party a liar "if there is basis in the evidence to do so."

A trial is supposed to be a search for the truth. This well-accepted maxim assumes that in most cases witnesses for one side are telling the truth and witnesses for the other side are not. Cross-examination has been hailed as the greatest weapon for exposing prevarication and arriving at the truth. If a witness has lied on direct examination, it is the job of the trial lawyer to expose that fact for the jury.

Against this backdrop, how can it reasonably be said that a lawyer shouldn't be able to call a witness a liar if there exists an evidentiary basis for it? Perhaps the *Kaas* court disliked the fact that the trial lawyer prefaced his statement by saying "I think" the witness is a liar. The "I think" preface has been taken by some courts as an expres-

sion of the lawyer's "personal opinion" in violation of Rule 4-3.4(3).

A good example of the view of many courts on the "I think/I believe" issue is found in *Sacred Heart Hospital v. Stone*, 650 So. 2d 676 (Fla. 1st DCA), *rev. denied*, 659 So. 2d 1089 (Fla. 1995). The opinion quotes the following sentences of a lawyer's final argument: "But, I *don't believe* there is any question. They admit she was at fault. She admits she was at fault."[14] The emphasis was supplied by the court, which held that such statements violate the Code of Professional Responsibility and constitute fundamental error.

The underlying prohibition against a lawyer expressing personal opinions is apparently premised on the belief that a jury will give more weight to the statement if the lawyer expresses it in the form of a personal opinion rather than as a comment on the evidence. Can it reasonably be said that a jury would react differently or reach another result if the lawyer, instead of saying "I don't believe there is any question she was at fault," says "*the evidence shows* she was at fault" or simply "she was at fault"? Clearly not. Yet the latter statements would be viewed as appropriate by even the most picky advocates and judges, while the former, at least in the view of some appellate courts, constitutes fundamental error.

The part of Rule 4-3.4 which provides the basis for so many reversals, *i.e.*, the prohibition against the expression of "*personal* opinion," cannot be meaningfully applied. Every time a lawyer comments on the evidence or suggests why their client is entitled to a verdict, the lawyer is expressing his or her own *opinion* on the subject. No one would suggest that a lawyer in closing can't comment on the evidence or suggest an appropriate verdict. How, then, can a court distinguish between permissible expression of opinion on what the evidence has shown or what constitutes a fair verdict and the prohibited expression of *personal* opinion? Obviously no such distinction can be drawn.

3) *Lack of Appellate Specificity*

To comply with appellate directives concerning the proper scope of closing argument, trial judges and trial lawyers must have specific appellate guidance. Some appellate decisions have failed to clearly identify which parts of a challenged argument are improper. For example, in *Sacred Heart*, the court

makes six separate references to the lawyer's use of the word "ridiculous" in argument. The court implies, but doesn't clearly state, that a lawyer can't use the word "ridiculous." There is little doubt that, given the court's treatment of "ridiculous," other appeals will be spawned as a result of verdicts in favor of the party whose attorney used that word in argument. Hopefully, the court did not truly intend to ban the word "ridiculous" from jury argument. If, however, that was the intent, the court should have said so, rather than leave the issue unsettled. Ambiguity breeds appeals.

Similarly, in *Baptist Hospital v. Rawson*, the court quotes several parts of the plaintiff's lawyer's closing argument. Several statements were clearly proper, *i.e.*, "it's a tragedy of errors," "none of these things are believable," "no one, not a president or a doctor is above the law," while others were not. The court failed to distinguish between the acceptable and unacceptable arguments, but found they *cumulatively* justified a new trial.

Proper appellate analysis of offending arguments is found in *Norman v. Gloria Farms, Inc.*, 668 So. 2d 1016 (Fla. 4th DCA 1996), in which the court prefaced its quotation of the offending arguments with the statement that, "the following arguments. . . we find to be an improper appeal to passions and prejudices of the jury on the critical issues of liability and financial responsibility."[15] The reader of *Norman* knows precisely what the court found to be prohibited argument.

Conclusion

Despite the best efforts of very capable and well-intentioned appellate judges, the law of closing argument remains wrought with uncertainty. The following measures may be helpful in minimizing that uncertainty:

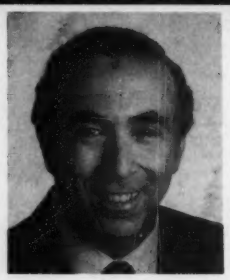
1) Abolish the part of the fundamental error rule that allows a party to preserve error without objecting to its adversaries' closing argument;

2) Adopt the approach of the Third District in *Forman* regarding statements of personal belief and abolish or amend the language of Rule 4-3.4 prohibiting statements of "personal" opinion about the credibility of witnesses;

3) Encourage appellate judges to identify with particularity those portions of arguments deemed improper.

Unlike many problems facing our system of justice, those discussed in this article are imminently correctable. All participants in the adversary system can and should commit to courses of conduct which will reduce the waste of judicial and litigants' resources caused by improper closing argument. ❑

AUTHOR



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This column is submitted on behalf of the Trial Lawyers Section, William B. Wilson, chair, and Brett Preston, editor.

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[1] *See* discussion at notes 12 through 13.

[2] While the argument may have engendered tender feelings in the plaintiff's lawyer's wife, it surely didn't in his client, who saw a million-dollar judgment disappear.

[3] *Martin v. State Farm*, 392 So. 2d 11, 12-13 (Fla. 5th D.C.A. 1980).

[4] *Donahue v. FPA Corporation*, ___ So. 2d ___, 21 Fla. L. Weekly D1325, D1326 (Fla. 4th D.C.A. June 5, 1996).

[5] Appellate courts encourage affirmative judicial action even absent objection. *Wasden v. Seaboard Coast Line Railroad Co.*, 474 So. 2d 825, 831 (Fla. 2d D.C.A. 1985) ("A trial judge can and should intervene to prohibit improper comments even when opposing counsel does not object."); *Hillson v. Deeson*, 383 So. 2d 732, 733 (Fla. 3d D.C.A. 1980) ("the trial court . . . should restrain these comments even absent an objection.").

[6] *Cohen v. Pollack*, 674 So. 2d 805 (Fla. 3d D.C.A. 1996); *Baptist Hospital, Inc. v. Rawson*, 674 So. 2d 777 (Fla. 1st D.C.A. 1996); and *Norman v. Gloria Farms, Inc.*, 668 So. 2d 1016 (Fla. 4th D.C.A. 1996).

[7] A thoughtful analysis of this issue is found in *Hagan v. Sun Bank of Mid-Florida, N.A.*, 666 So. 2d 580, 584 (Fla. 2d D.C.A. 1996), which concerns the "failure to accept the narrowness of fundamental error."

[8] For an error to be fundamental, it must go to the foundation of the case, the merits of the claim, or extinguish a party's right to a fair trial. *Wasden v. Seaboard Coast Line Railroad*, 474 So. 2d 825, 831 (Fla. 2d D.C.A. 1985), *rev. denied*, 484 So. 2d 9 (Fla. 1986). *Pippin v. Latosynski*, 622 So. 2d 566 (Fla. 5th D.C.A. 1993). Fundamental error occurs "if the prejudicial conduct in its collective import is so extensive that its influence pervades the trial, gravely impairing a calm and dispassionate consideration and the merits by the jury . . . ." *Tyus v. Apalachicola Northern Railroad Co.*, 130 So. 2d 580 (Fla. 1961).

[9] See cases cited in note 7, *supra*.

[10] *Walt Disney World Co. v. Blalock*, 640 So. 2d 1156, 1159 (Fla. 5th D.C.A. 1994) (Griffin, J., concurring in part; dissenting in part).

[11] *Baptist Hospital, Inc. v. Rawson*, 674 So. 2d at 779.

[12] The comments of Judge Sharp, dissenting in *Schubert v. Allstate Ins. Co.*, 603 So. 2d 554, 555 (Fla. 5th D.C.A. 1992), are apropos: "Had [plaintiff's counsel objected] early in the proceedings, the trial judge could have warned counsel for Allstate to stop such improper tactics, thereby forestalling the later improper comments. As it was, the trial judge was given no opportunity to remedy the situation. Further, failure to object can be part of trial counsel's strategy, to make the opponent look bad in the jury's eyes. Sometimes, it works, and sometimes it does not."

[13] The Second and Fourth districts have held that arguments that violate Rule 4-3.4(e) do not necessarily constitute fundamental error. *Wasden v. Seaboard Coast Line Railroad Co.*, 474 So. 2d 825 (Fla. 2d D.C.A. 1985), and *Nelson v. Reliance Ins. Co.*, 368 So. 2d361 (Fla. 4th D.C.A. 1978). The Third and Fifth districts have held the opposite, *see Stokes v. Wet 'N Wild, Inc.*, 523 So. 2d 181 (Fla. 5th D.C.A. 1988); *Schreir v. Parker*, 415 So. 2d 794 (Fla. 3d D.C.A. 1982). The First District has gone both ways. *Blue Grass Shows, Inc. v. Collins*, 614 So. 2d 626 (Fla. 1st D.C.A.), *rev. denied*, 624 So. 2d 264 (Fla. 1993); *Sacred Heart Hospital v. Stone*, 650 So. 2d 676 (Fla. 1st D.C.A. 1995). The conflicts between the districts on these and other issues have been commented upon in *Hagan* and *Norman*, cited in notes 6 and 7.

[14] *Sacred Heart Hospital v. Stone*, 650 So. 2d 676, 679 (Fla. 1st D.C.A.), *rev. denied*, 659 So. 2d 1089 (Fla. 1995).

[15] *Norman v. Gloria Farms, Inc.*, 668 So.2d at 1020-21.

Home Education and Shared Parental Responsibility

Under the statutory concept of shared parental responsibility, the issue of home education should be reviewed as an educational decision, and require joint determination and conference between parents

by Kevin P. Smith

Now, let me get this straight, madam, you've been teaching your children at home, and now your husband wants them in a public school, and you do not want them there, nor do you want them taught by a certified teacher? I see. And you want me to advise you whether you can continue this as your husband has just filed to dissolve your marriage. Well, I just don't know . . . ."

It is suggested that this would be a common reaction among family law practitioners when and if confronted with a mother's comment that she home educates the family's child or children. The parental choice to home educate one's children is a viable educational alternative in Florida.[1] The purpose of this article is to alert family law attorneys and the judiciary that this healthy and successful alternative must be carefully considered and properly presented at trial so that the "best interest of the child" is considered.

As our current public education system wrestles with issues such as charter schools, school vouchers, higher taxes, proposed national academic standards, and educational "goals," the movement to educate one's own children has steadily strengthened, but often gone unnoticed by the general public and legal community. It is estimated that as of 1991 between 300,000 and one million children were home educated in the United States.[2] Current Florida Department of Education information shows that for the 1994-1995 school year, over 19,000 children were educated at home in this state.[3] The figures for Florida represent a 16.7 percent increase in participation over the prior year.[4] The Department of Education figures certainly understate the correct total number of students, as those who home educate in conjunction with a private school were typically not reported in these totals.

Contrary to some popular misconceptions, a well-developed home education program is not isolationist, socially inhibiting, or "new." Actually, compulsory attendance at public school is the "new kid on the block," having become a legal requirement in most states only in the early 1900s.[5] "Traditional" education in our country often has been at home, with many of our founding fathers, former presidents, and leaders, such as George Washington, Daniel Webster, John Stuart Mill, Thomas Edison, Mark Twain, Franklin D. Roosevelt, and Abraham Lincoln, to mention but a few, having exhibited the fruits of this educational method.[6]

The social and academic benefits and implications for home-educated youth have been the subject of surveys and research projects.[7] Consistently, these investigations demonstrate that: 1) Parents can competently educate their own children;[8] 2) home-educated children are socially well-adjusted;[9] and 3) children demonstrate qualities of independent learning and leadership.[10] Children educated at home are admitted to numerous public and private universities and colleges including, as of 1994, at least four Ivy League schools and the U.S. Naval and Air Force academies.[11]

A family practitioner should be aware of the "home education" requirements set forth by statute. Pursuant to F.S. §232.02(4), the primary requirements to maintain a home-based school are threefold: 1) a written notice of intent filed with the county school superintendent; 2) the maintenance by the parent of a portfolio of records and materials; and 3) an annual evaluation of the child's progress.[12] If a parent meets these statutory requirements, then the home education program qualifies as a viable legal alternative to public or private schools in Florida. Alternative legal methods to maintain home education programs include incorporation as a private school under F.S. Ch. 617 or Ch. 623. These schools have been successfully acknowledged and maintained in Florida and are utilized by many home educators. The discussion of these options exceeds the scope of this article, but, if a client participates in such an "umbrella" program, the family practitioner must be familiar with these legal and popular alternatives.

In Florida, legal custody for children is known as parental responsibility and is found in F.S. §61.13. Pursuant to this statute, parents are presumed to "share" the parental responsibilities

and duties for their children.[13] F.S. §61.046(11) defines "shared parental responsibility" as follows:

> Shared parental responsibility means a court-ordered relationship in which both parties retain full parental rights and responsibilities with respect to their child and in which both parents confer with each other so that major decisions affecting the welfare of the child will be determined jointly.

Also set forth in F.S. §61.13 is the ability for the trial court to allocate or divide specific parental responsibilities, for example primary residence, between the parents.[14] In accord with this statutory authority, the parental responsibility for educational decisions may be awarded to one parent.[15]

At the time of divorce, parties may certainly disagree on a number of issues. The issue of educating the parties' child or children at home by one of the parties may be a hotly contested issue and a more frequent one as the number of participants in home education programs increase. The focus now becomes, when does the home education issue arise in shared parental responsibility disputes and how should counsel prepare to argue the benefits of such program on behalf of a client?

The issue of educating the parties' child at home by one of the parties may be a hotly contested issue and a more frequent one as the number of programs increase

At present, no Florida appellate decisions have involved the combined issues of home education and parental responsibility.[16] Nevertheless, under the statutory concept of shared parental responsibility, the issue of home education should be reviewed as an educational decision and, therefore, require joint determination and conference between parents. If the parties cannot agree, the court would need to determine which parent should make this "school choice" in the child's best interest.[17] Yet, counsel arguing the home education option must not only be prepared to present the client as the proper party to merit such designation but, also, counsel must be equipped to show the general and specific qualities of home education.

The contested issue of home education may arise at the time of divorce, as a home education program was part of the family's lifestyle, or in a post-dissolution enforcement or modification proceeding. As a practical matter, if the issue of home education is contested as part of the initial divorce, the party desiring to home educate should consider requesting an allocation of the educational responsibility from the trial court to avoid future problems.[18] Yet, the disagreement over home education often appears after entry of the final judgment, when one parent has elected this alternative and the former spouse opposes and seeks to force enrollment in public or private school or seeks to modify primary residence.[19] In such instances, the party who desires to home educate must be prepared to present and argue the merits of home education in defense or consider, if circumstances justify, a modification action to now obtain the responsibility for education.

Legal counsel should endeavor to learn the general background and demonstrated benefits of home education to properly represent this client. The home education alternative is growing stronger, not only in number of people, but also in public awareness, as shown by the 1996 Florida Legislature in passage of the "Craig Dickinson Act" (CS/HB 2505) known also as the "extra curricular student activities bill." Legal counsel needs to listen, learn, and thereafter argue with knowledge the home education alternative before the court. A successful educational program should not be defeated because legal counsel is not aware of or does not personally agree that the "best interest of the child" is education at home.

To represent a home education parent, counsel should again review the requirements set forth in F.S. §232.02(4). If a home education program is already commenced by one's client, the attorney should be certain it properly conforms with Florida law. If a client seeks to commence a home education program during or after a divorce, then counsel should verify his or her client has made every effort to confer and discuss with the former spouse before the program is begun and prior to seeking a judicial resolution. If the other parent objects, then as an alternative to initiating legal action, parties should consider mediation as an opportunity to fully "educate" the objecting parent and discuss the benefits of home education. Finally, counsel should consider requesting allocation or modification of the educational responsibility, if appropriate, when the opposing party refuses any reasonable cooperation with the request to home educate.

In preparation for an evidentiary hearing, counsel should learn the specific features of the client's individual home education program. Each program varies, but examples of similar features include academic curriculum, duration of individual programs, sports and social activities, club memberships, church activities and, if available, standardized test scores. Counsel should also discuss with the client their interaction with other "supporting" home educators in the local community. A

wealth of practical knowledge and potential witnesses can be obtained through local home education support groups and their leaders. The local school superintendent's office should have personnel available to testify as to clients' compliance with statutory requirements. Clients can identify teachers who may have performed prior annual evaluations for their children. In addition, written materials on home education, such as books, periodicals, statistical surveys, and reports are available in the marketplace and, in many areas, at the local public library. Materials may also be obtained through state and national home education associations, institutions, and foundations.[20]

At trial, the attorney representing a home-educating parent must be prepared to present evidence demonstrating the academic and social benefits of home education by introduction of surveys, research studies, statistical compilations, and the testimony of expert and lay witnesses. Most importantly, counsel needs to emphasize that the Florida home education parent is pursuing a legitimate and legal educational option. It can and should be argued that §232.02 "presumes" parental competency to teach as a parent may be, but typically is not, a certified teacher. Therefore, a parent's competency to educate should not become a focal issue unless there exist legitimate and serious deficiencies that merit consideration. Obviously, counsel should emphasize a parent's past home-education accomplishments, the academic achievement of the children, and prior standardized test results when these items demonstrate strong parental capabilities. Further, it should be shown by testimony that the well-intentioned home educator is not utilizing home education to alienate the opposing parent or to circumvent legitimate concerns from the other parent. Past efforts to confer and discuss the program should now be used to demonstrate good faith efforts to overcome an opponent's objections.

Personal opinions on the education of a party's children are abundant and do vary, but the summary rejection of an important educational alternative is not in the best interest of children. It is certainly acknowledged that home education is not practical, possible, or even desirable in all families. Yet, home education does serve many families, and matrimonial lawyers should be sufficiently knowledgeable to argue before our judiciary whether this is the "best interest of the child." If knowledgeable, then a lawyer's reaction to this article's opening comment might very well be, "I see. Tell me more about your program." ❑

[1] Several legal methods are available to home educate, but the most visible is pursuant to FLA. STAT. §232.02 (1995).

[2] BRIAN D. RAY, PH.D., NATIONAL HOME EDUCATION RESEARCH INSTITUTE, HOME EDUCATION RESEARCH FACT SHEET (1991); FACT SHEET incorporated studies done in 1989 (Ray) and 1991 (Lines). *See also* CHRISTOPHER J. KLICKA, J.D., THE RIGHT CHOICE: THE INCREDIBLE FAILURE OF PUBLIC EDUCATION AND THE RISING HOPE OF HOME SCHOOLING at 122 (1992); note 4, at 140.

[3] FLORIDA DEPARTMENT OF EDUCATION, STATISTICAL BRIEF at 1, FLORIDA HOME EDUCATION PROGRAMS 1994-95 (Series 96-12B, Jan. 1996). These figures are based upon a voluntary survey and do not include children who are home educated in conjunction with private schools.

[4] *Id.* at 1.

[5] KLICKA, *supra* note 2, at 112, 115.

[6] *Id.* at 146-156.

[7] For a brief summary of academic and social research studies, *see generally* RAY, *supra* note 2; *see* Dr. Larry Shyers, Comparison of Social Adjustment Between Home and Traditionally Schooled Students (social skills) (1992) (doctorate dissertation, University of Florida); *see also* KLICKA, *supra* note 2, at 126-132.

[8] BRIAN D. RAY, PH.D., 1990 NATIONAL HOME EDUCATIONAL RESEARCH INSTITUTE, A NATIONWIDE STUDY OF HOME EDUCATION: FAMILY CHARACTERISTICS, LEGAL MATTERS AND STUDENT ACHIEVEMENT.

[9] DR. JOHN WESLEY TAYLOR, SELF-CONCEPT IN HOME SCHOOLING CHILDREN (Ann Arbor, Michigan), *discussed in* KLICKA, *supra* note 2, at 135, note 42, and at 143; *see also* Mona Delahooke, Home Educated Children's Social/Emotional Adjustment and Academic Achievements: A Comparative Study (doctoral dissertation), *discussed in* KLICKA, *supra* note 2, at 135-136.

[10] Dr. Linda Montgomery, *The Effect of Home Schooling on Leadership Skills of Home Schooled Students*, HOME SCHOOL RESEARCHER (5) 1 (1989).

[11] Data compiled by Home School Legal Defense Association (Jan. 1994), *reprinted in* ALMANAC, FLORIDA PARENT EDUCATORS ASSOCIATION (Sept./Oct. 1994, back cover page); *see also* KLICKA, *supra* note 2, Appendix B (for data compiled from 1989-1992).

[12] FLA. STAT. §232.02(4) (1995).

[13] FLA. STAT. §61.13(2)(b)1 (1995); *see Vazquez v. Vazquez*, 443 So. 2d 313 (Fla. 4th D.C.A. 1983), *rev. den.*, 457 So. 2d 851 (Fla. 1984).

[14] FLA. STAT. §61.13(2)(b)2a (1995); *see Markham v. Markham*, 485 So. 2d 1299 (Fla. 5th D.C.A. 1986) (the award of "ultimate" responsibilities must be for specific areas); *see also Kuharcik v. Kuharcik*, 629 So. 2d 224 (Fla. 4th D.C.A. 1993); *Wheeler v. Wheeler*, 501 So. 2d 729 (Fla. 1st D.C.A. 1987).

[15] *Martinez v. Martinez*, 573 So. 2d 37 (Fla. 1st D.C.A. 1990), *rev. den.*, 581 So. 2d 1309 (Fla. 1991) (initial dissolution); *Peaden v. Slatcoff*, 522 So. 2d 959 (Fla. 1st D.C.A. 1988) (modification); *see also Holland v. Holland*, 458 So. 2d 81 (Fla. 5th D.C.A. 1984).

[16] For a national perspective, see THE RUTHERFORD INSTITUTE, CUSTODY BATTLES AND HOME EDUCATION (research article) (1992).

[17] *Gutierrez v. Medina*, 613 So. 2d 528 (Fla. 3d D.C.A. 1993); *see also Sotnick v. Sotnick*, 650 So. 2d 157 (Fla. 3d D.C.A. 1995).

[18] *But see Tamari v. Turko-Tamari*, 599 So. 2d 680 (Fla. 3d D.C.A. 1992) (trial court denied "open-ended" award of educational responsibility).

[19] *Gutierrez*, 613 So. 2d 528 (Fla. 3d D.C.A. 1993) (disagreement over educational choices does not necessitate modification of primary residence).

[20] For example, National Home Education Research Institute (Salem, OR); Home School Legal Defense Association (Paeonian Springs, VA); National Center for Home Education (Paeonian, VA); The Rutherford Institute (Charlottesville, VA).

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This column is submitted on behalf of the Family Law Section, Martin L. Haines III, chair, John Morse, editor, and Melinda Gamot, special editor.

A Formal Affair: Land Use Decisionmaking, and Obstacles Thereto, in the Post-*Snyder* Era

As the Section 28 *litigation illustrates, local governments may now be called upon to defend against multiple actions filed by the same party, at the same time, yet tried before different circuit court judges*

by Jeremy N. Jungreis

Florida is a fortunate state, endowed with unique and desirable lands. Over the last 40 years, growth in Florida has occurred at a remarkable rate, and shows no indication of declining.[1] Yet, desirability has come at a price. Rapid growth has yielded perpetually increasing demand for land and municipal services, and the imperative that state government "balance the need to provide for the large number of people coming to the state with the equally legitimate demand for the protection of the state's natural systems: land, air, and water."[2] In response, the Florida Legislature enacted comprehensive "Growth Management" legislation in 1972, 1975, and 1985.[3] Florida land use decisions are now valid only if they are "consistent" with state and local comprehensive plans.[4]

Unfortunately, the efforts of the legislature to facilitate managed growth have been frustrated by the well-intentioned decisions of the Florida Supreme Court in *Board of County Commissioners v. Snyder*, 627 So. 2d 469 (Fla. 1993), and *City of Melbourne v. Puma*, 630 So. 2d 1097 (Fla. 1994). The confusion created by *Snyder* and *Puma* is reflected in the subsequent decisions of the district courts of appeal. *Snyder* and *Puma*, which held that some (but not all) local land use decisions require the utilization of "quasi-judicial" procedures, have added uncertainty and expense into what is already a complex and cumbersome process.[5] The decision of the Fourth District Court of Appeal in *Martin County v. Yusem*, 664 So. 2d 976 (Fla. 4th DCA 1995), *review granted*, Table No. 87078 (Fla. July 19, 1996), which is being reviewed by the Florida Supreme Court, demonstrates the ambiguity which now exists. The Florida Supreme Court should utilize the *Yusem* case to resolve the uncertainty created by *Snyder* and *Puma*. The future of growth management in Florida might depend on it.

Comprehensive Planning and Rise of Growth Management

In 1985, the Florida Legislature mandated that all land use actions, no matter how great in scope, must be "consistent"[6] with a comprehensive plan. By 1992, all local governments in Florida were required to have promulgated and adopted local comprehensive plans that were consistent with the state comprehensive plan.[7] The idea of decisionmaking in accordance with a local "comprehensive plan" was not new. In 1926, the Standard State Zoning Enabling Act[8] suggested that zoning regulations should be drawn "in accordance with a comprehensive plan." Until the 1970s, however, Florida courts followed the lead of the U.S. Supreme Court[9] in holding that local government actions were valid as long as the legislative judgments behind the decisions were "fairly debatable."[10]

Florida's high growth status warranted long range planning and growth management by the early 1970s.[11] The "fairly debatable" standard often left state officials unable to effectively control growth. The Florida Legislature was forced to take remedial action. In 1972 and 1975, the legislature passed legislation[12] designed to give the state greater control over local land use planning, particularly as to regional impacts and environmentally sensitive lands.[13] The "Growth Management Act" of 1985 heralded the present era of Florida growth management.[14] The local comprehensive plan, which was required to be consistent with state and regional comprehensive plans,[15] would now be the "constitution" for local decisionmaking, with zoning as the primary method of carrying out the policies of the plan.[16]

Judicial Scrutiny of Land Use Decisionmaking

After passage of the Growth Management Act, the "fairly debatable" standard was rapidly narrowed in scope. With the rise in frequency of the "consistency challenge," courts began to exert greater scrutiny on land use decisions. Stricter scrutiny was particularly frequent in the context of rezonings. Where a land use decision was challenged as inconsistent with a local or regional comprehensive plan, courts repeatedly held that deferential review was inappropriate.[17] When the Florida Supreme Court decided *Snyder*, the modern trend in the district courts

of appeal appeared to be that many rezoning decisions should be made by local governments only after utilizing "quasi-judicial" procedures.[18]

The district courts, with the possible prior exception of the Fifth DCA,[19] appeared to recognize the distinction between zoning and planning. The determination of whether a land use decision is quasi-legislative or quasi-judicial is an important one. It affects the degree of formal procedures required during local land use decisionmaking, the character of the proceeding,[20] and the remedy on appeal to the circuit court.[21] The determination is also important because of the expense and time-intensive nature of formal proceedings both on affected parties and local governments.[22] Although the Florida Supreme Court has not definitively resolved what formal procedures "quasi-judicial" proceedings require, the opinion of the Third DCA in *Jennings v. Dade County*, 589 So. 2d 1337 (Fla. 3d DCA 1991), is instructive.[23] The level of process is not the same as that which is required in judicial trials, and strict rules of evidence do not apply. "A quasi-judicial hearing generally meets basic due process requirements if the parties are provided notice of the hearing and an opportunity to be heard. . . . [T]he parties must be able to present evidence, cross-examine witnesses, and be informed of all the facts upon which the commission acts."[24] *Jennings* indicates that a quasi-judicial hearing must include: 1) notice and opportunity for all affected parties to be heard; 2) the opportunity for parties to present evidence and cross-examine adverse witnesses; and 3) the right to be informed of the decisionmaker's findings on which the decision is based.[25] Open questions remain. While it is uncertain whether all testimony must be sworn, a local government must require it when demanded by the applicant.[26] Similarly, there has been no definitive guidance on what, if any, of the normal rules of evidence apply in a quasi-judicial proceeding.[27]

Florida Supreme Court Enters Fray: *Snyder* and *Puma*

By 1993, the district courts of appeal were split on the character of land use decisionmaking under the Growth Management Act. Ambiguity also persisted on the scope and availability of judicial review. Accordingly, in 1993, the Supreme Court accepted jurisdiction in three cases, *Puma v. City of Melbourne*, 630 So. 2d 1097 (Fla. 1994) (character of proceeding in comprehensive plan amendment); *Snyder v. Board of County Commissioners*, 627 So. 2d 469 (Fla. 1993) (character of proceeding in rezoning); and *Parker v. Leon County*, 627 So. 2d 476 (Fla. 1993).[28] With these three cases pending, the Supreme Court was "in a unique position to consider and resolve simultaneously the multiplicity of issues raised by the quasi-judicial debate."[29] Unfortunately, the Supreme Court's resolution of the three cases created more questions than it answered.

In an impassioned decision emphasizing the "constitutional" rights of property owners to "make a more intense use of [their] underzoned land,"[30] the Fifth DCA in *Snyder* held that most rezonings require quasi-judicial procedures, and ruled in favor of the applicant landowner.[31] The Supreme Court modified the lower court's rationale.[32] It did agree, however, with the Fifth DCA's functionalist approach for determining whether a rezoning requires quasi-judicial procedures. Starting with the premise that a legislative action "results in the *formulation* of a general rule of policy, whereas judicial action results in the *application* of a general rule of policy," the court determined that Brevard County's action on Snyder's application was in the nature of a quasi-judicial proceeding and properly reviewable by petition for certiorari. Important in the court's determination that the rezoning in *Snyder* was quasi-judicial was the fact that: 1) the rezoning had an impact on a limited number of persons or property owners; 2) the impact was on identifiable parties and interests, rather than the public at large; 3) the decision was arrived at through a hearing where facts were found and a decision was made from those facts; and 4) the decision "could be functionally viewed as policy application, rather than policy setting."[33]

Having determined that the rezoning under review was quasi-judicial, the Supreme Court delineated a test for determining the validity of action taken during a quasi-judicial hearing. First, the burden was on the applicant landowner seeking the rezoning change to demonstrate that the proposed development was in "strict compliance" with the local comprehensive plan. If this step was satisfied, the burden shifted to the local government to demonstrate that the decision not to rezone was in accordance with a legitimate public purpose.[34]

Many land use professionals believed that the amending of local comprehensive plans, as *formulation* of policy *applied* through zoning, remained quasi-legislative. The Supreme Court's decision in *City of Melbourne v. Puma*, 630 So. 2d 1097 (Fla. 1994), issued shortly after *Snyder*, quickly cast doubt on this assumption. *Puma* stated that *Snyder* resolved the conflict that had prompted the Supreme Court to take jurisdiction. The Supreme Court remanded the case to the Fifth DCA, for proceedings consistent with *Snyder*.[35]

Puma concerned a landowner's request *to amend a comprehensive plan*. *Snyder*, however, concerned a request for a rezoning. This naturally led to confusion. Did remand in accordance with *Snyder* mean that comprehensive plan amendments were subject to the same functionalist ad hoc inquiry to determine if quasi-judicial procedures were required? Or, was remand in accordance with *Snyder* simply an acknowledgment that "modifications to a policy-making document should be categorized as legislative acts?"[36]

Local Governments and Landowners Caught in Crossfire

Since *Puma*, the courts have unanimously followed the functionalist *Snyder* inquiry in plan amendment cases.[37] Cases have generally turned on what the court believes the plan amendment applicant is seeking. For example, is the applicant seeking to create new policy through amendment of the local plan, or simply requesting that the policies of the plan be applied to an individual parcel via site-specific amendments? The first plan amendment case to test the meaning of *Snyder* and *Puma* was *Florida Institute of Technology v. Martin County*, 641 So. 2d 898 (Fla. 4th DCA 1994).

In the early 1990s, the Florida Institute of Technology (FIT) regained through foreclosure an 81-acre parcel of waterfront property. The previous owner had obtained a comprehensive plan amendment and rezoning of the property which would permit the construction of an ambitious PUD.[38] FIT decided to develop the property consis-

tent with the prior amendments. The county planning staff, however, proposed to FIT that the county initiate a plan amendment and rezoning which would set up new timetables and parameters for the PUD. FIT agreed. The planning staff and FIT negotiated for several months and agreed on 11 potential developments, all of which were consistent with the comprehensive plan. Under intense public pressure not to abandon any public access to the Indian River, the Martin County Commission rejected all of the proposals.[39]

FIT filed a petition for certiorari in the circuit court. The county attacked the petition on the grounds that its action was quasi-legislative and therefore unassailable through certiorari.[40] Citing the Florida Supreme Court's decision in *Snyder*, the Fourth DCA disagreed. Because "the board hearings essentially addressed the change in the land use designation for a particular piece of property," the Fourth DCA determined that the FIT amendment was quasi-judicial in nature.[41]

One criticism of *FIT* is that the Fourth DCA did not need to apply the functionalist *Snyder* test to all plan amendment proceedings in order to reach the result that it wanted. The PUD had already been approved prior to FIT's foreclosure of the property. Hence, the court could have ruled based on the facts of the case that quasi-judicial procedures were necessary to protect previously acquired development rights. The hearing could have been analogous to a permit or variance denial hearing, and quasi-judicial, without invoking *Snyder*.[42]

FIT arguably presented a scenario where equity supported the requirement of quasi-judicial procedures. There were no such equity concerns in *Martin County v. Yusem*. In 1990, Melvyn Yusem applied for a rezoning and plan amendment to permit him to increase the intensity of use on his 54-acre parcel of land. The county approved the change as proposed. The Department of Community Affairs, however, rejected the proposed change. Rather than battle the DCA through the cumbersome procedures of the Growth Management Act,[43] Martin County chose to deny Yusem's application.[44] Yusem filed a petition for certiorari and an original action in circuit court, but later withdrew his request for certiorari. The circuit court conducted a trial de novo, and pursuant to *Snyder*, agreed that the county's action was quasi-judicial.

The character of a hearing to amend a comprehensive plan amendment is very different from a proceeding to rezone. A local government must strictly follow the legislatively mandated plan amendment procedures

The Fourth DCA agreed that the county's action was quasi-judicial because the court concluded that the county's decision had limited impact on the public. Yusem's proposed plan amendment would affect one piece of property of modest size (54 acres), with one owner. The Fourth DCA held that the circuit court lacked jurisdiction when it decided the case because Yusem had dismissed his certiorari petition.[45] The court instructed Yusem to start over by filing a new application for a plan amendment.[46] Recognizing that confusion was mounting regarding the proper role of *Snyder* in plan amendment cases, the *Yusem* court certified the issue to the Florida Supreme Court.[47]

The majority in *Yusem* failed to recognize the potential ramifications of applying *Snyder* in a case like *Yusem*. The character of a hearing to amend a comprehensive plan amendment is very different from a proceeding to rezone. A local government must strictly follow the legislatively mandated plan amendment procedures (which are nearly identical to plan adoption procedures) when conducting a plan amendment hearing.[48] The majority in *Yusem* ignored the fact that Martin County only denied Yusem's application because the DCA determined that the proposed plan amendment would be inconsistent with the other objectives and policies of the Martin County comprehensive plan. Moreover, the 54 acres at issue were part of a much larger parcel (900 acres) that would be affected by the proposed amendment.[49]

Section 28 Partnership v. Martin County, 642 So. 2d 609 (Fla. 4th DCA 1994) (*Section 28 I*) (petition for certiorari),[50] was the first plan amendment case to uphold quasi-legislative procedures under *Snyder*. The dispute in *Section 28* centered around one square mile of undeveloped land located slightly north of the Palm Beach County line. The parcel was situated at the headwaters of the Loxahatchee River,[51] and was bordered on two sides by Jonathan Dickenson State Park, a nature preserve.[52] The partnership's proposal was to build a high-density PUD on the land. Several obstacles stood in the way, however. First, there was a concurrency problem because "under the Martin County comprehensive plan, [the parcel did] not qualify for public water, sewer or other urban facilities necessary for development."[53] Second, the intensity of the proposed use was inconsistent with the Martin County comprehensive plan. The partnership sought amendments to the Martin County comprehensive plan that would eliminate these obstacles. The county denied the application.

Fearing that it might choose the wrong remedy, the partnership filed for every form of judicial and administrative relief available. The partnership filed a verified complaint with the county, a petition for certiorari in circuit court, and an original action in circuit court. The actions in circuit court were tried separately between different judges.[54] The petition for certiorari, *Section 28 I*, was dismissed by the circuit court because the court concluded that the underlying action was quasi-legislative in nature. The Fourth DCA affirmed the trial court's dismissal. The court reasoned that even though the plan amendment requested was "site-specific and owner- initiated," the fact that the PUD would require a new concurrency designation, and would significantly affect environmentally sensitive public lands, made the county's determination a *formulation* of policy, rather than an application of policy.[55]

The circuit court in the de novo original action, *Martin County v. Section 28 Partnership*, 676 So. 2d 532 (Fla. 4th DCA 1996) (*Section 28 II*) (original action), determined that the county's denial of the amendment was quasi-judi-

cial under *Snyder*. The circuit court found the county's actions unsupported by competent and substantial evidence. Citing *Section 28 I*, the Fourth DCA reversed.[56] Since the nature of the plan amendment denial was quasi-legislative, the trial court should have upheld the decision if "fairly debatable."[57]

Board of County Commr's v. Karp, 662 So. 2d 718 (Fla. 2d DCA 1995), was the first case outside of the Fourth DCA to discuss the role of *Snyder* in plan amendment proceedings. Sarasota County promulgated a comprehensive plan amendment that would change a 5.5-mile corridor from a "residential" classification to an "office" classification. The plan amendment affected 48 parcels, one of which was owned by the plaintiffs. The plaintiffs wanted the corridor redesignated for a more intense use so that they would be better able to obtain rezoning for a project they were contemplating. Despite the broad policy-driven nature of the county's action, the circuit court granted the plaintiffs' petition for certiorari reasoning that the county's action required quasi-judicial proceedings.[58] The Second DCA disagreed and reversed. It held the size of the parcel, the many interests affected by the plan amendment, and the interconnected nature of the elements of the Sarasota County comprehensive plan made the county's decision legislative.

The First DCA in *City Environmental Services Landfill v. Holmes County*, ___ So. 2d ___, 21 Fla. L. Weekly D1791 (Fla. 1st DCA Aug. 5, 1996), the most recent plan amendment case to interpret *Snyder*, apparently relied on *Section 28* in determining that a petition to add a regional landfill designation to a comprehensive plan was quasi-legislative. In reaching its decision, the court appeared to find persuasive the fact that a new land use designation would be created by the proposed plan amendment, and that the proposed amendment could produce county-wide environmental impacts.[59]

The cases illustrate that the uncertainty over whether a given plan amendment is quasi-legislative or quasi-judicial has been burdensome and expensive for all parties involved.[60] This reality is largely because the courts have not applied the *Snyder* factors in a manner that fosters predictability. A factor that may indicate policy *formulation* in one case, may support a conclusion of policy *application* in the next.[61] Moreover, because certiorari review is only appropriate where quasi-judicial procedures have been utilized, landowners have been forced to bring multiple actions to prevent dismissal by a good faith selection of the wrong remedy.[62] As the *Section 28* litigation illustrates, local governments may now be called upon to defend against multiple actions filed by the same party, at the same time, yet tried before different circuit court judges. The need to defend against duplicative litigation comes in addition to the requirement that local governments comply fully with the procedural requirements of the Growth Management Act.[63] These procedures have costs which are passed on to the taxpayers, and which threaten the continued viability of the Growth Management Act.[64] This could not have been what the Supreme Court intended when it decided *Snyder* and *Puma*.

Resolving the Ambiguity

There are several ways that the Florida Supreme Court could resolve the issues raised in *Yusem*. The court could follow the logic of *Machado*, and declare that all local comprehensive plans, as local land use "constitutions," are quasi-legislative in nature.[65] The court could then declare all rezonings, as *application* of policy, to be quasi-judicial in nature.[66] Such a bright-line rule would provide certainty to all affected parties, and transaction costs could be appreciably lowered. Aggrieved landowners would know exactly which remedy to seek in circuit court, while local governments would be less likely to have to defend their plan amendment decisions in duplicative actions and forums.

The Supreme Court should *not* affirm *Yusem*. All parties would be better off with a bright-line rule than a rule that adopts the ad hoc approach prevalent in the Fourth DCA. Under an all quasi-judicial rule, for example, parties would know that they must put sufficient competent evidence in the record to withstand certiorari review. Given the inconsistent judicial results that have been reached in the courts, parties now must assume formal procedures are always required.[67]

The Supreme Court might adopt a de minimus rule whereby most plan amendments would be quasi-legislative, unless the nature of the amendment is to effect a "site-specific, owner-initiated" amendment of the future land use map. An appropriate line of demarcation for such an approach is

suggested by F.S. §163.3187. Section 163.3187 permits more frequent plan amendments where the proposed amendment involves "a use of 10 acres or fewer of land" and "only proposes a . . . change to the future land use map (FLUM) for a site-specific small scale development activity." A recent circuit court decision, *Barco & Williams v. City of Jacksonville*, No. 96-51-AP, Slip Op. at 3-4 (Fla. 4th Cir. Ct. 1996), appears to have utilized §163.3187 in this manner.[68]

Florida was once the envy of many in the area of growth management reform. Having enacted a comprehensive system to promote ordered growth in accordance with state and local objectives, Florida seemed destined to effectively manage its growth well into the next century. Unfortunately, the intent of the Growth Management Act has been frustrated. The Florida Supreme Court should utilize *Yusem* as a means to clarify this area of the law. Failure to act decisively could lead to the demise of the Growth Management Act. And that would truly be a great loss for all Floridians. ❑

[1] During the 1980s, Florida's population grew by approximately 300,000 residents every year. BUREAU OF ECONOMIC AND RESEARCH: COLLEGE OF BUSINESS ADMINISTRATION, FLORIDA STATISTICAL ABSTRACT 38 (Anne H. Shermyen ed., 1991). Florida's population continues to increase at a rate of 900 people per day. Christina Binkley, *Florida Land Use Laws: A Solution to the Land Use Law? It Depends on What the Problem Is*, WALL ST. J., March 29, 1995, at F1.

[2] JOHN M. DEGROVE & DEBORAH A. MINESS, LINCOLN INSTITUTE OF LAND POLICY, THE NEW FRONTIER FOR LAND POLICY: PLANNING & GROWTH MANAGEMENT IN THE STATES 9 (1992).

[3] *See infra* notes 12-14 and accompanying text.

[4] *But see City of Jacksonville Beach v. Prom*, 656 So. 2d 581, 583 (Fla. 1st D.C.A. 1995) (local government should be allowed to authorize development consistent with zoning "[w]hen there is no current plan to implement the more intensive use permitted by the comprehensive plan."

[5] *See generally* Mary Dawson, Comment, *The Best Laid Plans: The Rise and Fall of Growth Management in Florida*, 11 J. LAND USE & ENVTL. L. 325 (1996).

[6] The term "consistent" is explained in FLA. STAT. §163.3194(3)(a). A land use decision will be consistent with a comprehensive plan if "the land uses . . . permitted by such order or regulation are compatible with and further the objectives . . . in the comprehensive plan and if it meets all other criteria enumerated by the local government." *Id. See also City of Cape Canaveral v. Mosher*, 467 So. 2d 468, 471 (Fla. 5th D.C.A. 1985) (Cowart, J., concurring).

[7] FLA. STAT. §163.3167 (1995).

[8] U.S. DEP'T OF COMMERCE, ADVISORY COMMITTEE ON ZONING, A STANDARD STATE ZONING ENABLING ACT (1926).

[9] *Village of Euclid v. Ambler Realty*, 272 U.S. 365, 388 (1926).

[10] *City of Miami Beach v. Ocean & Inland Co.*, 3 So. 2d 364, 366 (Fla. 1941).

[11] David L. Powell, *Managing Florida's Growth: The Next Generation*, 21 FLA. ST. U.L. REV. 223, 227 (1993).

[12] *See* Florida Environmental Land and Water Management Act, 1972 Fla. Laws ch. 72-317 (codified as amended at FLA. STAT. ch. 380 (1995)); Local Government Comprehensive Planning and Land Development Regulation Act of 1975, 1975 Fla. Laws ch. 75-257 (codified as amended at FLA. STAT. §§163.3161-163.3215 (1995)).

[13] *See* Powell, *supra* note 11, at 228.

[14] Two significant land use statutes were passed in 1985. The legislature enacted the State Comprehensive Plan, Ch. 85-57, 1985 Fla. Laws (codified as amended at FLA STAT. ch. 187 (1995), and the Omnibus Growth Management Act of 1985 (Growth Management Act), 1985 Fla. Laws ch. 85-55 (codified as amended at FLA. STAT. §§163.3161-163.3215 (1995)), which, in combination, imposed much stricter controls on the land use discretion of local governments, and gave affected citizens a greater voice in land use decisionmaking.

[15] FLA. STAT. §163.3184(5), (6) (1995).

[16] *See* FLA. STAT. §163.3201 (1995).

[17] For example, the Third DCA in *Machado v. Musgrove*, 519 So. 2d 629 (Fla. 3d D.C.A. 1987), held that all rezoning decisions are subject to "strict scrutiny" by the judiciary to ascertain whether the rezoning strictly complies with every element of the local comprehensive plan. *Id.* at 635-36.

[18] *See, e.g., Lee County v. Sunbelt Equities*, 619 So. 2d 996 (Fla. 2d D.C.A. 1993). The reasons for requiring quasi-judicial procedures in rezoning proceedings included: 1) the need to ensure a better record for determining consistency, and 2) the need to safeguard comprehensive planning against improper political influence. *Id.* at 1001.

[19] *See Bd. of County Commr's v. Snyder*, 595 So. 2d 65 (Fla. 5th D.C.A. 1991), *quashed and remanded*, 627 So. 2d 469 (Fla. 1993).

[20] *See Bd. of County Commr's v. Snyder*, 627 So. 2d 469, 474 (Fla. 1993).

[21] If a proceeding is quasi-judicial in nature, a landowner's remedy is through a request for common law certiorari. If a proceeding is legislative, an aggrieved landowner can seek declaratory or injunctive relief through a trial de novo in an original action in circuit court. *City Envtl. Servs. Landfill, Inc. v. Holmes County*, ___ So. 2d ___, 21 Fla. L. Weekly D1791, 1794 (Fla. 1st D.C.A. Aug. 5, 1996).

[22] *See* Thomas G. Pelham, *Quasi-Judicial Rezonings: A Commentary on the* Snyder *Decision and the Consistency Requirement*, 9 J. LAND USE & ENVTL. L. 243, 278-79 (1994).

[23] For an insightful discussion of the *Jennings* decision, see John W. Howell & David J. Russ, *Planning v. Zoning:* Snyder *Decision Changes Rezoning Standards*, 68 FLA. B.J. 21 (May 1994).

[24] *Jennings v. Dade County*, 589 So. 2d 1337, 1340 (Fla. 3d D.C.A. 1991).

[25] *Id.* The requirement that reasons be given on the record was adopted by the Second DCA in *Sunbelt Equities* and by the Fifth DCA in *Snyder*. The Supreme Court in *Snyder* stated that factual findings are not required to support the decision of the local decisionmaker, provided substantial and competent evidence otherwise exists in the record. *Bd. of County Commr's v. Snyder*, 627 So. 2d 469, 476 (Fla. 1993). *See also Pelham, supra* note 22, at 288.

[26] *See City of Apopka v. Orange County*, 299 So. 2d 657 (Fla. 4th D.C.A. 1974). *Cf. Connor v. Town of Palm Beach*, 398 So. 2d 952, 953 (Fla. 4th D.C.A. 1981) (indicating that sworn

"I will read that back to you . . . . Your wife said, 'I think this appointment to the bench has gone to your head, dear.'"

testimony is a necessary component of quasi-judicial procedure); *Goldberg v. Lee County*, Case No. 94-416 CA JRT, slip op. at 2 (Fla. 20th Cir. June 16, 1994), *cert. den.*, 665 So. 2d 224 (Fla. 2d D.C.A. 1995) ("[F]undamental due process required that witnesses be sworn before giving testimony in a quasi-judicial administrative proceeding.").

[27] Hence, whether there are any limitations on "expert" evidence or hearsay testimony remains an open issue.

[28] *Parker v. Leon County*, 627 So. 2d 476 (Fla. 1993). *Parker*, issued on the same day as *Snyder*, held that a landowner applying for a rezoning in a quasi-judicial proceeding (or presumably a plan amendment *if* characterized as quasi-judicial) is permitted to seek judicial review through common law certiorari, rather than the administrative procedures for challenging consistency set forth in the Growth Management Act).

[29] Pelham, *supra* note 22, at 283.

[30] *Bd. of County Commr's v. Snyder*, 595 So. 2d 65, 73 (Fla. 5th D.C.A. 1991), *quashed and remanded*, 627 So. 2d 469 (Fla. 1993).

[31] *Id.* at 78.

[32] *Bd. of County Commr's v. Snyder*, 627 So. 2d 469, 475 (Fla. 1993). The Supreme Court held that a local government desiring to maintain the status quo of a zoning classification must only show that maintaining the status quo "accomplishes a legitimate public purpose," and that the "refusal to rezone the property is not arbitrary, discriminatory, or unreasonable." *Id.* at 476.

[33] *Id.* at 474-75.

[34] *Id.* at 475-76.

[35] *City of Melbourne v. Puma*, 630 So. 2d 1097 (Fla. 1994).

[36] Pelham, *supra* note 22, at 300.

[37] *See, e.g., Martin County v. Yusem*, 664 So. 2d 976 (Fla. 4th D.C.A. 1995), *review granted*, Table No. 87078 (Fla. July 19, 1996); *City Envtl. Servs. Landfill, Inc. v. Holmes County*, ___ So. 2d ___, 21 Fla. L. Weekly D1791 (Fla. 1st D.C.A. Aug. 5, 1996).

[38] *Florida Institute of Technology v. Martin County*, 641 So. 2d 898 (Fla. 4th D.C.A. 1994).

[39] *Id.* at 898-99; Dawson, *supra* note 5, at 351-52.

[40] *FIT*, 641 So. 2d at 899.

[41] *Id.* at 900.

[42] *Cf. Bernard v. Town Council of Palm Beach*, 569 So. 2d 853 (Fla. 4th D.C.A. 1990).

[43] *See* FLA. STAT. §163.3184(10) (1995).

[44] *Martin County v. Yusem*, 664 So. 2d 976, 979 (Fla. 4th D.C.A. 1995) (Pariente, J., dissenting), *review granted*, Table No. 87078 (Fla. July 19, 1996).

[45] *Id.* at 977-78. There is a 30-day jurisdictional deadline for filing a petition for certiorari in circuit court. FLA. R. APP. P. 9.100(c). Yusem did not file his petition within 30 days of the county's action. *Yusem*, 664 So. 2d at 978 n.1.

[46] *Yusem*, 664 So. 2d at 978.

[47] *Id.* at 982 (upon motions for rehearing and clarification).

[48] *See* FLA. STAT. §163.3184(3).

[49] *Yusem*, 664 So. 2d at 979 (Pariente, J., dissenting).

[50] *Section 28 Partnership v. Martin County*, 642 So. 2d 609 (Fla. 4th D.C.A. 1994) (*Section 28 I*) (petition for certiorari); *Martin County v. Section 28 Partnership*, 676 So. 2d 532 (4th D.C.A. 1996) (*Section 28 II*) (original action).

[51] The National Park Service has designated the Loxahatchee River as a "Wild and Scenic River." *Section 28 I*, 642 So. 2d at 610.

[52] *Id.*

[53] *Id.* at 612. The partnership hoped to overcome the concurrency problem by creating a comprehensive plan designation that would permit it to obtain municipal services from neighboring Palm Beach County. *Id.*

[54] Dawson, *supra* note 5, at 354.

[55] *Section 28 I*, 642 So. 2d at 612.

[56] *Martin County v. Section 28 Partnership*, 676 So. 2d 532, 535 (Fla. 4th D.C.A. 1996) (*Section 28 II*) (original action).

[57] *Id.* at 535-36.

[58] *Board of County Commr's v. Karp*, 662 So. 2d 718, 719-720 (Fla. 2d D.C.A. 1995).

[59] *City Environmental Services Landfill v. Holmes County*, ___ So. 2d ___, 21 Fla. L. Weekly D1791, D1794 (Fla. 1st D.C.A. Aug. 5, 1996). The court did not adequately explain the reason it dismissed evidence indicating the property in question had been used as a landfill in the past, and that arguably no amendment to the comprehensive plan was necessary to permit the regional landfill.

[60] *See* Dawson, *supra* note 5, at 369 n.365. Dawson notes that the first phase of the *Section 28* litigation (*Section 28 I*) alone cost the citizens of Martin County $200,000 in litigation costs, and the developer $500,000. *Id.*

[61] For example, the Fourth DCA has utilized conflicting language on the issue of whether a "site-specific, owner-initiated rezoning" is quasi-judicial when the rezoning requires a plan amendment. *Compare Section 28 I*, 642 So. 2d at 612 ("The fact that [a comprehensive plan amendment] is site specific . . . is not necessarily determinative of the issue."), *with FIT*, 641 So. 2d at 900 ("The board hearings addressed the change in land use designation *for a particular piece of property* . . . which leads to the conclusion that this board's action . . . was quasi-judicial in nature.") (emphasis added).

[62] *See, e.g., Martin County v. Yusem*, 664 So. 2d 976 (Fla. 4th D.C.A. 1995), *review granted*, Table No. 87078 (Fla. July 19, 1996) (selection of improper remedy necessitated refiling of application).

[63] Local governments not only must negotiate approval of comprehensive plan amendments with the Department of Community Affairs, see FLA. STAT. §163.3184(8), (10), but also must defend their actions against citizen's suits. §163.3184(9)(a).

[64] The danger exists that local taxpayers will simply ask their state representatives to write comprehensive planning off as a noble but unworkable experiment. Perhaps sensing dissatisfaction in the electorate, bills were introduced in the 1996 Florida Legislature that would have overruled *Snyder* and *Yusem*. *See* Fla. SB 2570 (1996); Fla. HB 2187 (1996). The proposed legislation passed the House unanimously, but died in the Messages to the Senate.

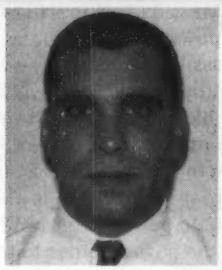
[65] *Compare Machado v. Musgrove*, 519 So. 2d 629, 632 (Fla. 3d D.C.A. 1987), *with Yusem*, 664 So. 2d at 979-80 (Pariente, J., dissenting); Pelham, *supra* note 22, at 300-301.

[66] *See* Pelham, *supra* note 22, at 284.

[67] *See Bd. of County Commr's v. Karp*, 662 So. 2d 718 (Fla. 2d D.C.A. 1995) (seemingly simple example of a quasi-legislative plan amendment proceeding—nevertheless ruled quasi-judicial by trial judge).

[68] Of course, §163.3187 *still* only designates the most intensive use for the parcel. It simply provides a streamlined process for small-scale FLUM amendments. One can reasonably argue that a small-scale FLUM amendment therefore remains legislative. This is consistent with the First DCA holding in *City of Jacksonville Beach v. Prom*, 656 So. 2d 581, 583 (Fla. 1st D.C.A. 1995), that a local government may allow development consistent with zoning that is less invasive than the FLUM allows.

AUTHOR



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This column is submitted on behalf of the Environmental and Land Use Law Section, Dennis M. Stotts, chair, and Sid F. Ansbacher, editor.

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Tax Consequences of a Power to Terminate a Nonmarital Trust

by Peter B. Tiernan

Most trust documents include some type of provision to terminate the trust. A power to terminate is beneficial particularly in situations where the trust might at some future date become too small to properly and economically administer or if the purpose of the trust might be accomplished before its stated termination date. Depending on who is the holder of this power and whom the power can be exercised in favor of, there can, however, be unanticipated estate and gift tax consequences in connection with a power to terminate a trust. These possible tax consequences must be carefully considered by the estate planner before including this type of power in any trust document.

Powers to terminate a trust are of two basic types. First, there is the totally unrestricted power to terminate which permits the power holder to terminate the trust in his or her discretion at any time and under any circumstances. The tax consequences of this type of power are relatively clear cut depending on who holds the power and whom the power can be exercised in favor of. The second type of power to terminate is the type that is only exercisable if a certain event or contingency occurs. If the event or contingency has not yet occurred, then this power is not presently exercisable and the power is deemed to be not in existence for tax purposes. This second type of power obviously presents more interesting and complex tax consequences for the estate planner to consider.

For purposes of this article, it is assumed that what is involved is a "nonmarital trust" in which the wife is the sole trustee and income beneficiary thereof, and her children are the remaindermen. It is further assumed that the surviving spouse is the holder of the power to terminate the trust in all instances. Consequently, most references to the power holder in this article shall be in the feminine. Finally, it is assumed that the surviving spouse has her separate estate worth exactly $600,000; she has not used any part of her unified credit and therefore no federal estate taxes would otherwise be due at her death barring any gift or estate taxes resulting from any power to terminate she might possess.

Because so many powers to terminate are drafted so they can only be exercised if a certain event or contingency occurs, the attorney/drafter must be aware of Regulation 20.2041-3(b)

Powers of Appointment

Any discussion of powers to terminate assumes a basic understanding of the federal estate and gift tax laws pertaining to powers of appointment. A power of appointment is a power that may be exercised either during life or by will to direct who shall become the owner of the property subject to the power. The fact that a power might not be called a power of appointment is immaterial. If it meets the rather broad definition of a power of appointment set forth in the regulations, then it is a power of appointment.

A power to terminate a trust is one of the types of powers set forth in the regulations as being a power of appointment.[1] However, because only general powers of appointment result in tax consequences to the power holder under §§2041 and 2514, there is a second determination that must be made to determine whether a particular power is a taxable general power or a nontaxable limited (or special) power. A general power of appointment (hereinafter "general power") is a power to appoint either to the power holder, her estate, her creditors, or the creditors of her estate.[2] A good rule of thumb in this regard is that if the power holder can directly or indirectly benefit herself in some manner, it is a general power; otherwise it is a limited power.

Because so many powers to terminate are drafted so they can only be exercised if a certain event or contingency occurs, there is one particular regulation that the attorney/drafter must be aware of. Regulation 20.2041-3(b) states that "a power which by its terms is exercisable only upon the occurrence during the decedent's life of an event or a contingency which did not in fact take place or occur during such time is not a power in existence on the date of the decedent's death." The effect of the above regulation is not to carve out an exception regarding what is a general power. Instead, this regulation provides that a power which is clearly a general power but which is subject to the occurence of a condition precedent that

has not occurred is not a power that is "presently exercisable," a term that will be used throughout this article.

Estate Tax Consequences of a Power to Terminate

• *Powers Benefiting the Surviving Spouse*

If the surviving spouse has a "presently exercisable" power to terminate a trust which would result in the entire corpus of the trust being distributed outright to her, then that power is clearly a general power and the property subject to that power would be included in her gross estate under §2041.

Although most nonmarital trusts do not provide the surviving spouse such an unrestricted power to terminate the trust in favor of herself, one power that is common to many trusts is:

> If the nonmarital trust at any time has a market value as determined by the trustee of $50,000 or less, the trustee may in her discretion terminate the trust and distribute the trust property proportionately to the persons then entitled to receive or have the benefit of the income of the trust.

As long as the power holder dies while the market value of the trust is above $50,000, Regulation 20.2041-3(b) indicates that the power is subject to a contingency which has not yet occurred and therefore "is not a power in existence at the date of the decedent's death." Consequently, there is no inclusion under §2041. If, however, because of distributions from the trust or a decrease in value of the assets of the trust, the market value ever goes below $50,000, then the event has occurred and since the surviving spouse is the person entitled to receive the income of this trust, her power to terminate would result in the inclusion of the entire current value of the trust in her gross estate. Considering the fact that the beginning estate tax rate is 37 percent, even a power to terminate a $49,000 trust can still result in approximately $18,000 of estate tax under the assumed facts of this article. Caution is therefore suggested before putting a termination provision like the above in a nonmarital trust because even though the trust value might currently exceed $50,000, there is no way of predicting what the value of the trust might be in the future.

Another type of power that a spouse could have in connection with a nonmarital trust which might become too small to administer effectively is the following:

> A trustee may, in her discretion, terminate this trust if she determines that the amount thereof does not warrant the cost of continuing said trust or its administration would otherwise be impractical. In the event of termination, the corpus of the trust shall be distributed to the persons then entitled to receive or have the benefit of the income of the trust . . . .

The case of *Estate of McCoy v. U.S.*, 374 F. Supp. 1321 (1974), *aff'd*, 511 F.2d 1090, has been cited as support for the position that a provision like the above does not constitute a general power under §2041. In this case, the court held that the language "the amount thereof does not warrant the cost of continuing said trust or its administration would otherwise be impractical" amounted to an ascertainable standard on which the trustee was required to make an objective finding. The court indicates that meeting the above ascertainable standard is a condition precedent to the trustee possessing the power to terminate. With reference to the court's use of the phrase "ascertainable standard" in its opinion, it should be clearly understood that the court is referring to an ascertainable standard that is something entirely different than the term "ascertainable standard" as defined under Regulation 20.2041-1(c)(2).

Although this case revolved around §2055 (relating to the charitable deduction) and although the court did not even mention §2041 in its opinion, the court is basically following the rule set forth in Regulation 20.2041-3(b) dealing with powers that are subject to an event or contingency. To put the court's opinion in the context of the regulations under §2041, unless the trustee could make an objective finding that the trust warrants termination based on the above-defined ascertainable standard, the contingency has not in fact occurred, and according to Regulation 20.2041-3(b), the power is deemed to be "not a power in existence on the date of the decedent's death."

One aspect regarding the *McCoy* case that must be clarified is the misconception that it supports the position that the above-quoted termination provision is not a general power under §2041.[3] This is incorrect. If we go back to the definition of what constitutes a general power, a power to terminate which results in the power holder receiving the principal of the trust is a power to ben-

efit oneself and therefore is a general power. The only position that the *McCoy* case supports is that if a general power may only be exercised upon the occurrence of an event which has not yet occurred, then that general power is a power that is "not in existence" as of that time. Due care is therefore suggested regarding the inclusion of this type of power in a nonmarital trust because if the condition does ever occur, it will result in inclusion under §2041.

In drafting a power to terminate which is only exercisable upon the occurrence of a specific event or contingency, there are certain potential problem areas that must be considered and avoided. The first type of situation to avoid in this regard is a power that gives the trustee complete and total authority over the determination as to whether the event or contingency authorizing the exercise of the power has occurred. For example, consider the following power to terminate:

> The trustee may terminate the trust at any time if the trustee in her sole and absolute discretion deems that the amount thereof does not warrant the cost of continuing said trust or its administration would otherwise be impractical. In the event of termination the property shall be distributed to the persons then entitled to the income from the trust.

In the above example, in light of the trustee's sole and complete authority over the determination as to whether the event or contingency has occurred, the trustee's power to terminate the trust is no longer restricted by an objective ascertainable standard. For this reason, this type of power to terminate should run afoul of §2041. Remember, the more discretion given to the spouse over the determination, the more likely the IRS will question that power.

Another issue that the attorney should be concerned with when drafting a power to terminate is what constitutes an "ascertainable standard" as that term is used in the *McCoy* case. As previously stated, it should be understood that we are not talking about an ascertainable standard for someone's health, support, education, and maintenance as defined in Regulation 20.2041-1(c)(2). Rather, we are concerned with whether the language used to describe the event or contingency under which the trustee can exercise her power to terminate is a standard that is "precise, definite, and ascertainable." Is it language on which the trustee can make an objective finding? The language used to describe the circumstances under which the power to terminate was exercisable in the *McCoy* case was determined by that court to be such a clear, definite, and ascertainable standard. However, to the extent an attorney varies from language that is precise, definite, and ascertainable then that standard is vulnerable to attack.

The language to describe the circumstances under which the power to terminate was exercisable in McCoy *was determined by that court to be such a clear, definite, and ascertainable standard*

A third issue that the attorney should be concerned with when drafting a contingent power to terminate is whether the surviving spouse can, by her actions, bring about the event or contingency, thereby making her power "presently exercisable."

Regulation 20.2041-3(b) states that if a power is exercisable only upon the occurrence of an event or contingency which has not in fact occurred, then the power is deemed not a power in existence at the time of decedent's death. Until recently, this regulation was thought to be relatively clear and therefore easy to use to prevent tax consequences with powers that otherwise are clearly taxable general powers. However, there is a recent Tax Court case that indicates how a power that might appear to meet the above regulation may not in fact be protected.

The case of *Estate of Ethel B. Kurz v. Commissioner*, 101 T.C. 44 (1993), *reh. den.*, 67 T.C.M. 2978, *aff'd*, (7th Cir.) 95-2 USTC ¶60,215, involved one half of a "Five and Five Power" (the power to withdraw five percent of principal) in connection with a nonmarital trust. The surviving spouse possessed the power to withdraw five percent of the value of said trust; provided, however, that no amounts could be withdrawn until she had first completely exhausted the principal of the marital trust, which she also had an unlimited power of withdrawal from, but which contained well over $3 million at the date of her death. The court reviewed Regulation 20.2041-3(b) and held that even though the decedent's power to withdraw was subject to a contingency (the complete exhaustion of the marital trust which had not in fact occurred), that power was still taxable under §2041. The court reasoned that the power was taxable under §2041, because 1) the power to exhaust the marital trust (and bring her power over the nonmarital trust into being) was within her control, and 2) that event did not have a significant nontax consequence independent of the spouse's ability to exercise the power. In reaching its decision the court stated that, "although the condition does not have to be beyond the decedent's control, it must have some significant nontax consequence independent of the decedent's power to appoint the property."[4] Further the court said "[a] condition that has no significant nontax consequence independent of a decedent's power to appoint the property for her own benefit does not prevent practical ownership; it is illusory and should be ignored."[5]

The significance of the *Kurz* case is that it is not strictly limited to situations involving Five and Five Powers. This case also has application to any other contingent power to withdraw income or principal from trusts as well as a contingent power to terminate a trust. Assume, for example, that a power to terminate is similar to the following: "The trustee, in her sole discretion, may terminate the nonmarital trust if the gross income for any three consecutive fiscal years of the trust is not sufficient to cover the costs and expenses of the trust. In the event of termination . . . ."

Although the above provision sets forth something that is definite and specific enough to constitute an ascertainable standard under the *McCoy* rationale, the surviving spouse by her investment choices can reduce the gross income so that it does not cover the costs and expenses of the trust. Does this event have a significant nontax consequence independent of the

spouse's ability to terminate the trust as required by the *Kurz* case? The answer appears to be "no."

This situation is to be contrasted with a situation where, for example, the spouse has discretion to terminate the nonmarital trust if she ever conceives a child, adopts a child, gets remarried, or quits a job. Under §2038, these are examples of when nontax consequences greatly overshadow the event's significance for tax purposes. Since the court in *Kurz* relied heavily on §2038 as support for its opinion, the above events should likewise be permissible events under §2041. All other situations in which a power is drafted that gives the spouse substantial control over the events or contingencies which can make her power to terminate exercisable are vulnerable, however, and the practitioner should consider this aspect in drafting the power.

• *Power in Favor of Children*

If the surviving spouse has a presently exercisable power to terminate the trust, but the corpus upon termination goes to someone other than the spouse such as her children, then since the spouse has no power to benefit herself, she does not have a general power under §2041. There is, however, one important exception to this rule when the power is exercisable in favor of persons whom the spouse is legally obligated to support. In such a situation, the spouse has a power to indirectly benefit herself and therefore the power is taxable under §2041.[8]

This article assumes that the type of trust that is involved is a nonmarital trust. However, because of a potential trap for the unwary, it is necessary that a few comments be made about marital deduction trusts and powers to terminate in favor of children. It is not a coincidence that powers of termination in trust form books almost always provide that upon termination the corpus of the trust is distributed "to the person then entitled to receive or have the benefit of the income of the trust." To provide otherwise in the power to terminate would disqualify the trust for the marital deduction in the case of a QTIP Marital Trust.[9] In the case of a general power of appointment marital trust although the trust would qualify for the marital deduction assuming the spouse also possesses a qualifying testamentary power of appointment,[8] the exercise of the power to terminate would result in gift tax consequences to the surviving spouse. Consequently, although powers to terminate in favor of children may be acceptable in nonmarital trusts, never include them in any trust for which a marital deduction may be desired.

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Gift Tax Consequences of a Power to Terminate

• *Power in Favor of Spouse*

If the surviving spouse has the presently exercisable power to terminate the trust, this power also has significant gift tax consequences. If by terminating the trust she would be entitled to the corpus of the trust, *then whether or not she chose to exercise it,* she has a general power over the remainder interest, the lapse of which constitutes a transfer for gift tax purposes.[9] Therefore, every year that she does not exercise her power, there is a lapse of that power which is deemed to be a release and gift tax consequences will occur under §2514.

• *Power in Favor of Someone Other Than Spouse*

If the surviving spouse has the presently exercisable power to terminate the nonmarital trust, but someone other than her would receive the corpus of the trust when she exercises this power, the regulations in Example (3) of Regulation 25.2514-3(e) indicate that no taxable transfer has been made with respect to the remainder interest, but that a taxable gift has been made of her income interest (*see* Regulation 25.2514-(b)(2)). Presumably, this example assumes that X (the recipient) is not someone who the income beneficiary (L) is legally obligated to support. Otherwise, the power should be taxable.[10]

Although the surviving spouse in the above situation must exercise a power to terminate in favor of her children to incur gift tax consequences, if such a power is included in a nonmarital trust then sooner or later one of the children is going to learn about this power and with either no advice or incorrect advice ask his mother to exercise the power. Although the amount of the gift is limited to the present value of the "income interest," even if the power holder is a 72-year-old woman the value of her income interest is 49.962 percent (as of January 1996) of the total value of the trust assets. Since 49.962 percent of a $600,000 nonmarital trust would result in a gift of over $299,772, the resulting estate tax under the assumed facts of this article (the gift would reduce the unified credit available at the surviving spouse's death) would be in excess of $113,000. Consequently, the only situation in which a power to terminate a nonmarital trust in favor of children should be considered is with a nonmarital trust where all the income is either being accumulated or paid to someone other than the spouse. In these situations there is no income interest that the spouse can dispose of.

To avoid possible §2511 tax consequences as indicated above, an attorney might be tempted to draft a power to terminate which provides that upon termination the corpus is distributed among the spouse/income beneficiary and the children/remaindermen in accordance with the present values of their respective interests in the trust. Consider the following provision:

> A trustee may, in her discretion, terminate this trust at any time during its duration. In the event of termination, the corpus of the trust shall be distributed among the income beneficiary and the remaindermen in accordance with the actuarially computed values of their respective interests in the trust at the date of termination.

This provision appears to solve the §2511 gift tax consequences. This provision also appears to be similar to the power described in Example (1) in Regulation 20.2041-3(f) in which it was determined that §2041 did not apply. Because the only thing the surviving spouse would receive upon termination is what she is entitled to receive based on actuarial tables and because she could, barring a spendthrift clause, al-

ways sell her income interest to achieve approximately the same result, there should be no problem with this approach. Do not, however, use the above provision with a marital trust for the reasons mentioned previously.

Significance of F.S §737.402(4) to Powers to Terminate

In 1991, the Florida Legislature amended F.S. §737.402 by adding a new subparagraph (4) which applies to trustees of certain types of trusts who are also beneficiaries of such trusts. The effect of this new addition to F.S. §737.402 is to prohibit the exercise of certain powers held by a trustee to the extent that they permit the trustee/beneficiary to make distributions to herself which are not limited to her health, support, education, or maintenance.

Statutes like F.S. §737.402(4) have been enacted in various states and have been approved by the Internal Revenue Service as effective in prohibiting trustees from exercising certain powers that would otherwise be general powers.[11] They are based on the premise that the issue of whether a power is "in existence" is controlled by state law as opposed to federal law.[12] Therefore, assuming that a nonmarital trust stated that the spouse/trustee was authorized to make distributions to herself as were necessary for her "health, support, and best interests," the spouse would be prohibited from making any distributions for her "best interests" although presumably she could still make distributions for her "health and support." The statute would superimpose a statutory prohibition prohibiting the trustee/beneficiary from exercising the power for other than her health, support, education, or maintenance and in theory should prevent estate and gift tax consequences with most improperly drafted powers in trusts.

Does the enactment of §737.402(4) have any application to a power to terminate a trust? Assuming that what is involved is a power to terminate that is presently exercisable, the issue is whether this is "a power conferred on a trustee to make discretionary distributions of either principal or income to or for the benefit of such trustee . . ." as that language is used in the statute. In this respect, the term "distributions"as defined in *Black's Law Dictionary* appears to be broad enough to include the type of distribution of trust assets in a termination. Although it will take a court decision based on both the definition of the term "distribution" and possibly on how the power to terminate is worded, a court could make a distinction between a withdrawal power which is clearly envisioned by the statute versus a termination power which probably is not so envisioned. One distinction between these two powers is that with a withdrawal power the trustee has both the discretion on when to make the distribution and how much to distribute while the only discretion with a termination power would be if and when to exercise the power.

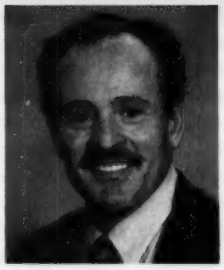
The possibility that F.S. §737.402(4) might apply to termination powers could be beneficial to a taxpayer in the event that a power to terminate in an existing document is asserted by the IRS to be taxable under either §2041 or §2514. In this event, it should be argued that the trustee is prohibited by state law from exercising her power to terminate and therefore there are no tax consequences in connection with this power. Of course, if the trustee still wanted to terminate the trust, she could always apply to a court of competent jurisdiction as provided in this statute.

Conclusion

What should an attorney do when the husband has died and the surviving spouse brings in a will containing a nonmarital trust, hopefully prepared by another attorney, that contains a power to terminate that is currently exercisable? First, under the right circumstances there is always the possibility of disclaiming this power. If, however, you don't get to see the trust until after the disclaimer period has expired, you might, under the appropriate facts, consider advising the spouse to resign as trustee. This would be advisable if, for example, she has a power to terminate a trust under $50,000 and the current value of the trust is approaching, but has not yet declined to that value. Another situation where resigning might be an option is in the situation where the principal of the trust will go to the spouse's children upon exercise of the power to terminate. If the spouse resigns and a child as successor trustee decides to terminate the trust, there should be no gift tax consequences to the spouse if properly planned. However, because not every situation will have a solution, there is no substitute to proper drafting of the power to terminate. ❑

[1] Regulation 20.2041-1(b).
[2] I.R.C. §2041(b)(1).
[3] *See* B.N.A. #326-2d at A-38.
[4] *Estate of Ethel B. Kurz v. Commissioner*, 101 T.C. 44, 60 (1993), *reh. den.*, 67 T.C.M. 2978, *aff'd*, (7th Cir.) 95-2 USTC ¶60,215.
[5] *Id.*
[6] Rev. Rul. 79-154, 1979-1 C.B. 301.
[7] I.R.C. §2056(b)(7)(B)(ii)(II) and Priv. Ltr. Rul. 8319009.
[8] Rev. Rul. 72-154, 1972-1 C.B. 310.
[9] Regulation 25.2514-3(e) Example (3).
[10] *See supra* note 6.
[11] *See* Rev. Rul. 54-153, 1954-1 CB 185 and Rev. Proc. 94-44, 1994-2 CB 683.
[12] *Helvering v. Stuart*, 317 U.S. 154 (1942).

AUTHOR



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Florida Statute §849.0935 Drawings by Chance

by Kent J. Perez

Feeling amazingly upbeat and positive for a lawyer, one Saturday morning you come out of your local K-Mart after dashing in for a few sorely needed items when you are approached by a young man who asks if you would like to buy a chance to win a vintage 1965 Mustang convertible for only $10 a ticket. The convertible belongs to the local antique auto club. He advises you that the money is for a worthy cause and that a drawing will be held sometime the week before Christmas.

Having graduated from law school clueless and then becoming educated through the practice of law, the first thought that comes to your mind is, "This can't be that easy." Your second thought is, "I wonder who represents them?" After asking to see at least a picture of the Mustang, you slowly fork over $10 to receive a little ticket with a number on it and a tab that requires filling out your name, address, and telephone number. You tear off the completed tab and hand it back to the young man, then stuff the ticket of chance into your pocket soon to be forgotten.

The Game

Charities and other not-for-profit organizations are always addressing ways to increase revenues and solicit more funds. An attractive way to do this is to hold a raffle or drawing by chance. A drawing by chance is really nothing more than a lottery.[1] It consists of the three elements of a lottery which are prize, chance, and consideration.[2]

As a practicing attorney, what do you need to know to advise the local antique auto club on how to lawfully hold this drawing of chance? Well, for starters, Florida has a general prohibition against gambling with the exception of pari-mutuel wagering, and the State of Florida Lottery.[3] Ch. 849 of the Florida Statutes is entitled "Gambling," and proscribes a host of activities including conducting a lottery, keeping a gambling house, playing games of chance, unlawfully betting on the results of trial or contest of skill, and possessing gambling paraphernalia, among others.

The legislature intended to recognize certain exemptions to gambling prohibitions, provided that the activity is conducted in a manner that by strict definition does not equate to gambling

When one thumbs through Ch. 849 and the various types of conduct that constitute gambling activity, it becomes apparent that the legislature intended to recognize certain exemptions to gambling prohibitions, provided that the activity is conducted in a manner that by strict definition does not equate to gambling. This may seem to be a somewhat backward approach, yet one of these so-called exemptions would be your first stop and your main stop in the Florida Statutes, as you seek to give the local auto club legal advice.[4]

Since a pure drawing of chance or raffle is nothing more than a lottery consisting of the elements of prize, chance (the drawing of the winning ticket), and consideration (price paid for a chance), these statutory exemptions permit activities which appear to be a form of gambling conduct only if one of those elements has been removed. This is really not so much an exemption as it is an acknowledgment that removing one of the elements of a lottery allows a lawful activity to exist. Here, it is important to distinguish the difference between a drawing of chance conducted by charitable not-for-profit organizations pursuant to F.S. §849.0935 and the same type of activity similarly conducted by retail businesses as for-profit organizations pursuant to F.S. §§849.092 and 849.094.

How many times have you driven through McDonalds to receive a game piece in hopes of winning a large cash sum or at a minimum, a Big Mac? This type of activity is addressed in F.S. §§849.092, "Retail Merchandising Business," and 849.094, "Game Promotions in Connection with the Sale of Consumer Products or Services." In these two statutes, the Florida Legislature allows the retail marketplace to conduct chance activities; however, the element of consideration necessary to comprise a lottery is clearly and conspicuously prohibited.[5] This is best known to you by the key phrase of "No purchase necessary." These "game promotions" are strictly regulated by the Department of State requiring registration and bonding if the prizes are in excess of $5,000.[6]

Of course, it becomes confusing when you walk into your local supermarket and find out that hidden under a bottle cap is a star icon worth $500,000 if only you had purchased the right six-pack

of your favorite beverage. In these retail for-profit game promotions, what the marketing world doesn't make extremely obvious is the fact that you are afforded just as much right under the law to participate in this sweepstakes promotion with no requirement of making any purchase or expending any consideration. This is the same way that your local hardware store operates when they want to give away a new riding lawn mower. They can advertise for customers to come into the store and put their name, address, and telephone number into a box and conduct a random drawing to give away this wonderful piece of machinery.

In both of these scenarios, a prize is being offered by a retail merchant in connection with the sale of a consumer good or service, and chance is the method by which this prize shall be given away. Entry into these promotions is open to the entire world and no consideration, that is, at least no monetary consideration, can by law be required. F.S. §849.0935, on the other hand, is entitled "Charitable non-profit organizations; drawings by chance; required disclosures; unlawful acts and practices; penalties" and implicitly recognizes that tangible monetary exchange can occur in the form of a donation or contribution to a lawfully registered charitable cause, provided that this consideration is not required as a condition of entering the drawing.[7] This section will be the focus of this article.

The Law

F.S. §849.0935 exists fundamentally the same as when it was originally passed in 1984.[8] While materials expressing the legislative intent of this section are lacking and case law is nonexistent, it would seem safe to presume that the original statute as passed in 1984 was intended to provide some authorization and guidance to your local church or other charitable organization wanting to conduct their annual raffle and giveaway in order to raise money for their organizations.[9] As the law currently exists, subsection 849.0935(1) sets forth the definitions of a "drawing by chance" and "operator." A drawing by chance simply includes the random selection of a winner from entries submitted by the public. It does not by definition include those enterprises commonly known as matching, instant winner, or preselected sweepstakes promotions that involve, for example, a mailing of previously designated winning numbers to the public. The law also defines the term "operator" as an organization qualified under federal law as a 501(c)(3) not-for-profit corporation. This is key to the existence of this statute.

A drawing by chance includes the random selection of a winner from entries submitted by the public. It does not include matching, instant winner, or preselected sweepstakes promotions

Building on these definitions, subsection 849.0935(2) says that the prohibition against an illegal lottery in this state shall not be construed to prohibit an organization from conducting a drawing by chance for fund-raising purposes if the operator is an organization qualified under 26 U.S.C. §501(c)(3), and has complied with the applicable provisions of F.S. Ch. 496, The Solicitation of Contributions Act.[10]

Subsection 849.095(3)(a)-(d) sets forth disclosure requirements of a specific nature for all brochures, advertisements, notices, tickets, or entry blanks used in connection with a drawing by chance. It requires disclosure of the rules governing the conduct and operation of the drawing, the name of the organization or operator and its principal place of business, the source of the funds used to award cash prizes or purchase prizes, and the date, hour, and place where the winner will be chosen unless advertisement of the drawing is not offered to the public more than three days prior to the drawing.

Subsections 849.0935(4)(a)-(f) set forth a list of prohibitions making it unlawful for any operator who engages in a drawing by chance or promotes, operates, or conducts a drawing by chance to conduct any drawing in which the winner is predetermined by means of matching, instant winner, preselected sweepstakes, or otherwise in which the selection of winners is in any way rigged; require monetary consideration as a condition for entering the drawing; remove, disqualify, disallow, or reject an entry or discriminate in any manner between entrants who gave contributions; fail to notify at the address on the entry blank, any person whose entry is selected to win, of the fact that they are a winner; fail to award all prizes offered in the manner and at the time stated; and print, publish, or circulate literature or advertisement used in connection with the drawing that is false, deceptive, or misleading.

In this subsection list of prohibitions, (4)(b) specifically states it is unlawful "to require an entry fee, payment, proof of purchase, or contribution as a condition of entering the drawing or being selected." As in F.S. §§849.092 and 849.094, the express prohibition of consideration as a condition of entering a retail game promotion or drawing by chance is fundamental to these exemptions allowing for chance activities. The argument also exists that this specific expression overrules Florida case law defining the lottery element of consideration, at least for purposes of these sections.[11] That is, by reading these subsections .092, .0935, and .094, one could argue that the focus is now directed toward tangible monetary consideration only and no longer the case law interpretation of any consideration sufficient to enter into a contract.

Finally, subsections 849.0935(5) and (6) set forth the penalties for anyone who violates this law and exempts the state lottery operated pursuant to Ch. 24. The penalty for a violation of F.S. §849.0935 is a second degree misdemeanor with the exception of a violation of the advertising disclosures of date, time, and place, punishable as a second degree misdemeanor by fine only.

Further Clarification

Now that we have read the statute, how do we apply the law? Facing an absence of case law, a further understanding of F.S. §849.0935 in today's marketplace and the current gambling fervor can be found in two opinions of the Office of the Attorney General. AGO 93-59 repeats the statute, but AGO 93-

85 provides insight. AGO 93-85 was issued December 3, 1993, as a result of a request from the Office of the State Attorney, Ninth Judicial Circuit. Certain law enforcement agencies and prosecutors in Orange and Seminole counties were experiencing resistance from individuals who chose to interpret F.S. §849.0935 in what the state attorney considered to be an incorrect application and abuse of the law.

Television commercials were appearing all over the Orlando/Disney World area inviting individuals to enter into a sweepstakes being conducted by a well-known community not-for-profit charitable organization. This particular organization, in conjunction with a third party promoter, was soliciting the public to purchase tickets of $100 per entry in exchange for the opportunity to win a house and a yacht, but with the giveaway contingent upon the receipt of at least the sum of money necessary to pay for the house and the yacht. Any additional monies would then go to the not-for-profit organization. The advertising for this sweepstakes also expressed the reserved right to cancel this giveaway promotion. State Attorney Lawson Lamar asked some basic questions regarding the application of this statute.[12]

First, may a promoter who is a Ch. 496 registered professional solicitor, conduct and profit from a private lottery or drawing by chance operated by a charitable organization, if some of the proceeds benefit the charitable organization? The Attorney General opinion answers this question by stating that a drawing by chance may be lawfully conducted by a promoter provided that the operator is an organization qualified as a 501(c)(3) and is in compliance with F.S. Ch. 496, The Solicitation of Contributions Act. That act further imposes restrictions and registration requirements on charitable organizations, sponsors, and professional solicitors, who solicit funds. The opinion concludes that a professional solicitor is not precluded from assisting a qualified operator in a drawing by chance provided the professional solicitor is an employee, officer, or agent of the qualified organization and is acting in compliance with the requirements of Ch. 496. This interpretation would seem to make it clear that the application of §849.0935 could arguably go beyond your local neighborhood charitable organization to assist a large group like the Red Cross in conducting a commercial drawing by chance. However, it seems that the possible commercialization of the privilege to conduct a raffle lacks a practical application in the marketplace with little pecuniary benefit when AGO 93-85 declares the entire world is entitled to a ticket without contributing, and the giveaway prize must exist independent of the drawing.

May a (registered professional solicitor) conduct and profit from a private lottery or drawing by chance operated by a charitable organization, if some proceeds benefit the organization?

Second, the state attorney asked whether advertising a drawing by chance without indicating that no purchase or contribution is necessary to enter the drawing, and displaying a dollar amount in connection with the advertisement, is in violation of subsection (4) of §849.0935. The opinion responds succinctly, stating that in light of the requirement for the advertisements to refrain from the use of false, deceptive, or misleading information, literature, and materials, and the prohibition on requiring an entry fee, payment, proof of purchase, or a contribution as a condition of entering the drawing, a promotion that states a dollar amount in conjunction with the drawing and then fails to provide additional language stating that no purchase or contribution is necessary in order to participate in the drawing, is misleading and deceptive in violation of the prohibitions set forth under F.S. §849.0935. This interpretation, in the opinion of this author, is crucial to any charitable or not-for-profit organization that desires to engage in a drawing by chance and offers that drawing by chance to the general public. The focus must remain on the fact that no consideration is necessary to enter into a drawing by chance, and the fact that this drawing is being conducted in conjunction with the organization's request for a donation in their lawful solicitation of contributions. While the statute, as currently written, does not require the phrase, "no purchase or contribution is necessary for participation," using language such as "tickets cost $100" or "entry fee is $100/person" will create a false impression among the consumer public that a contribution is necessary to enter the drawing. The impression created, however, should be viewed as a whole. Allowing the organization to suggest a minimum contribution or donation along with the disclosure that no contribution is necessary seems an acceptable alternative.

Third, the state attorney asked whether a drawing by chance that sets forth rules allowing the operator to fail to award prizes if no contributions are received or if the promoter is not satisfied with the amount of contributions received violates this law. The Office of the Attorney General again replies in keeping with what appears to have been the original intent of this particular statute. Section 849.0935(4)(e) clearly makes it "unlawful for any operator to fail to award all prizes offered in the manner and at the time stated." This, coupled with the fact that §849.0935 constitutes a limited exception to the general prohibition against gambling in this state, leads the Attorney General to conclude that since this statute contemplates that a prize will be awarded, accordingly, there is no grant to an operator to cancel a drawing or refuse to award a prize regardless of the reason. The Attorney General clarifies §849.0935(4)(e) by its literal language of prohibiting an operator from failing to award all prizes offered. Here again, it seems the intent of this statute was to allow a local nonprofit charitable organization to solicit funds by offering a prize in exchange for donations received without tying the giveaway prize to the amount of contributions received.

Fourth, the state attorney essentially restates question three. "May the operator of a drawing by chance reserve the right to cancel?" The opinion answers *again* that as no contingencies appear to be allowed, *i.e.*, the drawing

cannot require a level or amount of contribution, and as §849.0935(3)(d) requires specific disclosures on advertisements, brochures, notices, tickets, and entry blanks, as to the date, hour, and place where a winner will be chosen, the statute does not authorize or contemplate the canceling of the drawing at the mere discretion of the operator.

Finally, the state attorney asked whether an operator under §849.0935 must have an independent source for the prize giveaway, as opposed to using funds received to purchase the prize to be awarded. The Attorney General opinion responds that an operator who does not have the prize at the time the tickets or entries are offered, but relies on contributions to obtain the prize, violates F.S. §849.0935. This conclusion follows the presumed intent to keep the prizes and expenses of the drawing independent from the solicitation of contributions as there can be no guarantee that sufficient contributions will be received. To permit otherwise would have the impact of placing unknown numbers of charities and not-for-profit organizations on par with the likes of Las Vegas and Atlantic City, effectively, allowing these entities to engage in drawings by chance at the level of a commercial enterprise. A simple examination of the historical abuses behind Florida's statutory bingo exemption to unlawful gambling would provide the nightmarish glimpse of how this drawing by chance privilege could also be abused.[13]

Changes

During the 1994 and 1995 legislative sessions, attempts were made to provide statutory amendments to the drawings by chance law. In the 1994 session, a bill was sponsored by Rep. Elaine Bloom and Sen. Donald Sullivan that incorporated clarification of the interpretations set forth in AGO 93-85. In the provision of law requiring disclosure of date, hour, and place where the winner will be chosen, language was added to specifically require the disclosure of the place the prizes will be awarded. The proposed language made it abundantly clear that all brochures, advertisements, notices, tickets, etc., used in connection with the drawing must conspicuously disclose that no purchase or contribution is necessary. Further, the 1994 proposed changes to F.S. §849.0935 made it unlawful to require a donation, or substantial consideration, in addition to an entry fee, payment, proof of purchase, or contribution as a condition of entering the drawing or being selected to win a prize. It set forth specific prohibitions to canceling a drawing, or purchasing or obtaining a prize with voluntary donations or contributions, and identified a violation of §849.0935 as a deceptive and unfair trade practice actionable under Florida's Little FTC Act.[14]

During the 1994 and 1995 legislative sessions, attempts were made to provide statutory amendments to the drawings by chance law

The 1994 bills carrying these changes to F.S. §849.0935 also contained revisions requested by the Department of State to F.S. §849.094, "Game Promotions in Connection with the Sale of a Consumer Good or Service."[15] Presented as a cleanup piece of legislation, it easily passed its House committees and the full member body of the House only to die on the Senate special calendar a victim of time during a hectic 1994 session.

A worthy endeavor, the same piece of legislation was picked up in the 1995 session as a proposed committee bill and interim project by the House Committee on Regulated Industries. The bill traveled in essentially the same form as 1994 during the 1995 session with some minor changes to the proposed revisions of §849.0935. Two key changes to the 1995 revisions were changing the word "operator" to "organization" to clarify who may conduct a drawing by chance, and adding language to state that nothing would prohibit an organization from suggesting a minimum donation or from including a statement of any suggested minimum donation on their advertising material. Specific language was also added to make it unlawful for an organization to condition a drawing on a minimum number of tickets having been dispersed to contributors or on a minimum number of contributions having been received. The 1995 version of the bill again traveled with revisions to F.S. §849.094, "Game Promotions in Connection with the Sale of a Good or Service," that would make it easier for the Department of State to register and enforce proper compliance with those retail game promotions.

The 1995 bill, explained by committee to provide greater consumer protection and to assist not only organizations authorized to conduct drawings by chance but also legitimate businesses, found itself as perhaps the only bill addressing revisions to F.S. Ch. 849 to pass both the House and Senate chambers. Needless to say, any piece of legislation that was moving with a high probability of success and dealing with changes to Florida's gambling laws became extremely attractive to varied legislative interests. After several attempts by interests to use this bill as a vehicle to make changes to other provisions of Ch. 849, it became apparent that this piece of legislation would not survive.[16]

Changes to §849.0935 based on AGO 93-85 surfaced again in the 1996 session as a "strike everything after the enacting clause" to House Bill 407 by Rep. Mike Fasano. Rep. Fasano's original HB 407 was amended in the House Regulated Industries Committee and became CS/HB 407 which, after being withdrawn from the remaining committees of reference, was placed on the House calendar. A similar bill in the Senate was amended to conform to the House version and passed the Senate Regulated Industries Committee.

CS/HB 407 passed the full House the last week of session with a floor amendment that restated the prohibited nexus between receipt of donations and the purchase of the prize to be awarded.

The language was reworded to make it unlawful to condition the acquisition or giveaway of any prize upon the receipt of voluntary donations or contributions. This would allow an organization to effectively use its receipts for any debt incurred, even those connected with the prize to be awarded, as long as the receipts and acquisition remain two separate and independent functions of the giveaway. In the final days of the 1996 session, CS/HB 407 also passed the Senate. It became law without the Governor's signature.

Conclusion

For the most part, charitable and not-for-profit organizations are worthwhile endeavors that seek to make life better for needy people in their communities. It is probably for this reason that the legislature will continue to grant these organizations the privilege to conduct drawings by chance and other solicitation activities. These activities are about being free and unregulated and are truly intended to benefit a worthy cause. However, this privilege must always be balanced against the legislature's commitment to protect the public from fraud and abuse and the current will of the public to prohibit gambling in the State of Florida.

Your local charitable or civic organization will be able to give away their donated prizes at the Fourth of July picnic by requesting contributions and placing everyone's name in a hat. The antique auto club may even choose to raffle off a vintage Mustang, depending on the structure of their organization. However, an attempt to use this statute to take charitable not-for-profit organizations from a community giveaway level to the sophisticated business of a questionable commercial enterprise, raises significant questions of state policy and can only result in potential abuse to the general public. ❑

[1] At common law lotteries were illegal only when they became public nuisances. *See Lee v. City of Miami*, 121 Fla. 93, 163 So. 486 (1935).

[2] *See Little River Theater Corporation v. State ex rel. Hodge*, 185 So. 855 (1939), *Dorman v. Publix-Saenger-Sparks Theaters*, 184 So. 886 (Fla. 1938). *And see* AGO 90-58 and AGO 58-266.

[3] *See* FLA. CONST. art. 10, §§7 and 15, FLA. STAT. Ch. 849, "Gambling," and *Barron v. State*, 271 So. 2d 115 (1972). Note, however, FLA. STAT. Ch. 849 does permit bingo and certain penny-ante games.

[4] Depending on the nature of the activity, several other Florida statutes may have application to the practices undertaken by not-for-profit charitable organizations. *See also* FLA. STAT. Ch. 496, The Charitable Solicitations Act, and FLA. STAT. Ch. 501, Part II, The Deceptive and Unfair Trade Practices Act.

[5] *See* FLA. STAT. §849.092(3)(a) (no person to be eligible to receive such a gift shall ever be required to pay any tangible consideration to such licensee in the form of money or other property or thing of value), and FLA. STAT. §849.094(2)(e) (unlawful to require an entry fee, payment, or proof of purchase as a condition of entering a game promotion).

[6] *See id.* §849.094.

[7] *See id.* §849.0935(4)(b).

[8] *Id.* §849.0935, as passed in 1984, was amended by HB 1193, Fla. Laws ch. 88-115 (1988), to add the word "tickets" to §849.0935(3) requiring all brochures, advertisements, notices, *tickets*, or entry blanks used in connection with a drawing by chance to conspicuously disclose the rules of the drawing, the name of the operator and its place of business, and the source of funds used to award the prizes. Also added to this list of disclosure requirements, was "(d)" requiring the date, hour, and place where the winner will be chosen to be disclosed unless the brochures, advertisements, notices, tickets, or entry blanks are not offered to the public more than three days prior to the drawing. In keeping with this newly required disclosure, additional language was added to §849.0935(5), providing that any operator or other person who sells or offers for sale in this state a ticket or entry blank for a raffle or other drawing by chance without complying with the requirements of (3)(d) is guilty of a misdemeanor of the second degree punishable by fine only. *See* Fla. Laws ch. 88-115.

[9] When FLA. STAT. §849.0935 was enacted in 1984 as an exception to the general prohibition against any person conducting a lottery in this state, a key feature was the provision that no donation or minimum payment could be required as a condition for participating in the raffle. The absence of the consideration requirement in the raffles authorized by FLA. STAT. §849.0935, ensured that such activities would, if conducted according to the statute, not violate the lottery prohibition. Organizations conducting fund-raiser drawings by chance are allowed only to ask for a donation but not require a donation for a chance at winning the prize to be given away. Even persons who elect not to make a contribution must be given a chance to win the prize if they request one.

[10] *See* §§496.401-496.424, cited as the Solicitation of Contributions Act. This law is regulated by the Department of Agriculture and Consumer Services and requires registration of organizations, fund-raising consultants, professional solicitors, charitable organizations, and sponsors. It specifies prohibited acts and sets forth available remedies.

[11] Where only tangible monetary consideration is specifically prohibited, would the use of other consideration with the elements of prize and chance, for the purposes of the activities identified by these statutes, constitute an illegal lottery? The argument could be made that the enactment of FLA. STAT. §§849.092 and 849.094 referring explicitly to tangible monetary consideration, does for purposes of these sections overrule the standing case law interpretations of lottery consideration. (*See Blackburn v. Ippolito* (App., 156 So. 2d 550 (1963), *cert. denied*, 166 So. 2d 150). Pecuniary consideration is not necessary to constitute a lottery. Consideration necessary to establish a simple contract is sufficient.)

[12] FLA. STAT. §849.0935 in its current form is entitled, "Charitable, non-profit organizations; drawings by chance; required disclosure; unlawful acts and practices; penalties."

[13] *See* report of the 12th Statewide Grand Jury regarding the operation of commercial bingo halls in the State of Florida, case no. 83,964, Supreme Court, State of Florida.

[14] The Florida Legislature has no less than 16 specific statutory locations identifying acts or practices that would be literal per se violations of §501.203(3)(c) of Florida's Deceptive and Unfair Trade Practices Act. Recent legislative changes to this law should make it applicable to charitable not-for-profit organizations.

[15] *See* HB 1733 and SB 2100 from the 1994 Legislative Session.

[16] *See* CS/HB 2483 and CS/SB 1008 of the 1995 Legislative Session.

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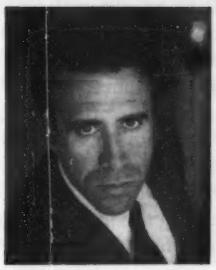

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This is column is submitted on behalf of the Government Lawyer Section, Thomas W. Hall, chair, and Allen Grossman, editor.

■

Computer Software Patents

Anything Under the Sun Made by Man

by Robert Kain

As of March 29, 1996, patents on computer programs are considerably easier to obtain from the U.S. Patent and Trademark Office. Newly implemented guidelines[1] for the examination of computer-related inventions provide that software, when stored on some type of computer-readable medium (such as random access memory or RAM, read-only memory or ROM, CD-ROMs or magnetic discs), is patentable. Not all software is patentable simply because it is stored on magnetic media. Music, text, other literary works and simple data compilations are not protectable subject matter under the patent laws as currently construed by the Patent and Trademark Office.

Earlier decisions by the courts and the appellate tribunal in the Patent and Trademark Office[2] had generally held that the mathematical formula must be intrinsically tied to a machine[3] or the claimed invention must include language linking the invention to a significant post-solution activity.[4] The courts and the Patent and Trademark Office appellate tribunal either invalidated patent claims or refused to approve proposed claims in a patent application as being "not directed to statutory material" in a variety of situations. In the past, claims covering methods of doing business,[5] pre-empting of mathematical formulas,[6] describing simple data-gathering steps linked to mathematical formulas[7] or containing insignificant post-solution activity coupled with mathematical algorithms[8] have all been declared "nonstatutory" under 35 USC §101 of the patent statute.[9]

To be patentable under the new guidelines, the software must provide some type of function to the computer. This software feature is described in the examination guidelines as "functional descriptive material" set forth in the patent claims in contrast to music and textual material which is identified as "nonfunctional descriptive material." Functional descriptive material consists of data structures and computer programs which impart functionality to the computer when encoded on a computer-readable medium (RAM, ROM, CD-ROM, or disc). A patent claim for a computer-readable medium encoded with a data structure or computer program defines structural and functional interrelationships between the data structure and the medium which permit the data structure's functionality to be realized. According to the guidelines, these functional data structures are patentable under 35 USC §101 of the patent statute.[10] Nonfunctional descriptive material includes "music, literature, art, photographs, and mere arrangements or compilations of facts or data which are merely stored so as to be read or outputted by a computer without creating any functional interrelationship, either as part of the stored data or as part of the computing process performed by the computer."[11]

In cautionary language, the Patent Office states that the guidelines are not formal Patent Office rules and, hence, do not have the force and effect of law

The guidelines provide that Patent and Trademark Office personnel should be "prudent" in applying the tests to identify nonfunctional descriptive material. Nonfunctional material may be claimed in combination with other functional descriptive material to provide the necessary functional and structural interrelationships to satisfy the requirement of §101 and hence make the claim patentable under that portion of the patent statute. The guidelines give an example of a program which reads musical notes from memory and, upon recognizing a particular sequence, causes another defined series of notes to be played. The guidelines state that such a computer program defines a functional interrelationship among the data which renders the claimed program patentable as a statutory process even though the program stores music in the magnetic media.

The patent examiner is directed to read the written description of the invention in the patent application because that description provides the clearest explanation of the applicant's invention. The examiner must 1) determine what the programmed computer does, *i.e.*, the functionality of the programmed computer; 2) how the computer is configured, *i.e.*, what elements constitute the programmed computer and how those elements are configured and interrelated; and 3) the relationship of the programmed computer to other devices, materials, or processes outside the computer.

The claims in a patent define the property rights provided by the patent[12] and the goal of claim analysis is to identify the boundaries of protection sought by the applicant.[13] Claims can be generally broken down into certain categories, *i.e.*, 1) claims relating to a process, and 2) claims relating to an apparatus, device, or a product. For process claims, the words in the claim, called claim limitations, define steps or acts to be performed. For devices or products, claim limitations define discrete physical structures which may be hardware or a combination of hardware and software.

To determine whether a claimed invention falls within a protectable statutory class of invention under §101, the patent examiner should classify each claim into one or more statutory or nonstatutory categories.[14] Even if the examiner finds that a claim falls into a nonstatutory category, this is only an initial finding and the examiner should continue with the examination process and determine whether the claimed invention complies with the novelty requirement, the nonobviousness requirement, and the enablement requirement set forth in 35 USC §§102, 103 and 112. "If the invention as set forth in the written description is statutory, but the claims define subject matter that is not, the deficiency can be corrected by an appropriate amendment of the claims. In such a case, Patent and Trademark Office personnel should reject the claims drawn to nonstatutory subject matter under §101 but identify the features of that invention that would render the claimed subject matter statutory if recited in the claim."[15]

In addition to the determination that the claim is patentable under §101, the patent examiner must determine whether the subject matter sought to be patented is a *useful* process, machine, article of manufacture or composition of matter, *i.e.*, the invention must have a practical application.

Also, the software must be new, compared with all other computer programs and computer systems (the novelty requirement under 35 USC §102) and must be different enough from pre-existing programs and systems such that the differences are not obvious to computer programmers or other persons skilled in the particular field of technology (the nonobvious requirement under 35 USC §103). The Patent Office recognizes that computer-related inventions normally involve more than one field of technology. For example, a computer program to improve the efficiency of an automated car wash involves applications of computer-related technology and automated car wash technology. The patent examiner must be assured that the patent application and patent claim(s) are novel, nonobvious, and are fully explained such that the skilled artisan in the computer arts and the artisan in the selected or targeted field of technology understands the invention.[16]

The Patent and Trademark Office has been wrestling with these examination guidelines since October 1995. The initial proposed guidelines[17] were quite generous in their treatment of computer programs. However, after public comment and a review by various government agencies, the guidelines were revised to narrow the scope of protection for computer patents and to better reflect current law expounded by the U.S. Supreme Court and the Court of Appeals for the Federal Circuit.[18]

Natural phenomena such as energy, magnetism, and electricity are not patentable.[19] Neither are mathematical formulas or algorithms[20] such as $E=MC^2$, Einstein's theory of relativity. However, the guidelines state that a patent claim directed to a practical application of those principles is patentable under the law. Claims specifying physical characteristics of forms of energy, its frequency, voltage level, or the strength of a magnetic field, define energy or magnetism per se and as such are nonstatutory natural phenomena. "However, a claim directed to a practical application of a natural phenomenon such as energy or magnetism is statutory."[21]

The guidelines provide that when a product claim encompasses any and every computer implementation of a process, when read in light of the patent specification, the claim should be examined on the basis of the underlying process.[22] When Patent and Trademark Office personnel have found that the claim is not limited to a specific machine or article of manufacture, the burden shifts to the applicant to demonstrate why the claimed invention should be limited to a specific machine or manufacturer.

If a product claim does not encompass any and every computer-implementation of a process, then it must be treated as a specific machine or article of manufacture. Generally, a claim drawn to a particular programmed computer should identify the elements of the computer and indicate how those elements are configured in either hardware or a combination of hardware and specific software. "A claim limited to a specific machine or manufacture, which has a practical application in the technological arts, is statutory."[23]

In describing statutory process claims, the guidelines provide that these process claims must 1) result in a physical transformation outside the computer for which a practical application in the technological arts is either disclosed in the specification or would have been known to a skilled artisan, or 2) be limited by the language in the claim to a practical application within the technological arts.[24] Further, "the claimed practical application must be a further limitation upon the claimed subject matter if the process is confined to the internal operations of the computer."[25]

In the past, courts have approved patents on computer programs that measure heartbeat or cardiac activity in order to predict the vulnerability to ventricular tachycardia (a cardiac abnormality) after a heart attack,[26] on systems that display CAT scan information in a certain way,[27] and an electronic analysis of seismic waves.[28]

The guidelines take this analytical process a step further in that the Patent Office indicates the following are patentable subject matter: controlling the transfer, storage, and retrieval of data between a cache and a hard disk storage device such that the most frequently used data is readily available; controlling parallel processors to accomplish multi-tasking of several computing tasks to maximize computing efficiency; word processing programs which change the state of the computer's arithmetic logic unit (the CPU) when program instructions are executed; and, removing noise from a digital signal by subtracting a correction signal from the digital signal. The guidelines state that these types of claims are "limited to a practical application of the abstract idea or mathematical algorithm in the technical arts."[29]

Not everything in the guidelines sup-

ports the broad concept that "anything under the sun made by man"[30] is patentable. In cautionary language, the Patent Office states that the guidelines are not formal Patent Office rules and, hence, do not have the force and effect of law. If a patent examiner does not follow the guidelines, the examiner's decision is neither appealable nor petitionable to the Commissioner of Patents. Further, and more importantly, the Patent Office has indicated that the examiners may still rely on an older analytical framework established in case law dating back to 1978.[31]

Although the new examination guidelines propose a better analytical framework for determining whether a computer program for a mathematical formula, for example, is patentable, in view of the disclaiming language in the introductory portion of the guidelines, it is uncertain whether every examiner in the Patent and Trademark Office will adhere to the guidelines. A recent district court case[32] decided three days prior to the effective date of the guidelines did not follow the progressive theories proposed by the Patent and Trademark Office. Further, the court criticized the exemplary "patentable" claims in the guidelines as being "helpful . . . only when referring to particular cases [cited in the guidelines]."[33] Ultimately, patent practitioners in this field expect the Court of Appeals for the Federal Circuit to weigh in and rule on the analytical framework established by the guidelines. The Federal Circuit has indicated a willingness to defer to the Patent Office in at least one case involving a computer program.[34] ❑

[1] *Examination Guidelines for Computer-Related Inventions*, 61 Fed. Reg. 7478, March 29, 1996, effective date March 29, 1996.

[2] The Board of Patent Appeals and Interferences initially reviews decisions of the patent examining corp. 35 U.S.C. §134. Subsequent appeals are available to the Court of Appeals for the Federal Circuit under 35 U.S.C. §141 or de novo review in the U.S. District Court for the District of Columbia under 35 U.S.C. §145.

[3] *Arrhythmia Research Tech. v. Corazonix Corp.*, 958 F.2d 1053, 22 U.S.P.Q.2d 1033 (Fed. Cir. 1992).

[4] *Diamond v. Diehr*, 450 U.S. 175, 209 U.S.P.Q. 1 (1981).

[5] *Ex parte Murray*, 9 U.S.P.Q.2d 1819 (Bd. of Pat. App. 1988) (a program for computing expenses is not patentable because it is a method of doing business).

[6] *Gottschalk v. Benson*, 409 U.S. 63, 175 U.S.P.Q. 673 (1972) (converting a number into a different format is not patentable).

[7] *In re Gelnovatch*, 595 F.2d 32, 201 U.S.P.Q. 136 (CCPA 1979) (computing one set of numbers from another set of numbers is not patentable).

[8] *Parker v. Flook*, 437 U.S. 584, 198 U.S.P.Q. 193 (1978) (updating alarm limits for the catalytic conversion of hydrocarbons is not patentable because of insignificant post-solution activity).

[9] The patent statute provides "[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title." 35 U.S.C. §101. "The term 'process' means process, art, or method, and includes a new use of a known process, machine, manufacture, composition of matter, or material." 35 U.S.C. §100(b).

[10] *Guidelines*, 61 Fed. Reg. 7478, 7481.

[11] *Id.*

[12] *Fromson v. Advance Offset Plate, Inc.*, 720 F.2d 1565, 219 U.S.P.Q. 1137 (Fed. Cir. 1983).

[13] *Guidelines*, 61 Fed. Reg. 7478, 7480.

[14] *Guidelines*, 61 Fed. Reg. 7478, 7481.

[15] *Id.*

[16] *Guidelines*, 61 Fed. Reg. 7478, 7486.

[17] *Proposed Examination Guidelines for Computer-Implemented Inventions*, 60 Fed. Reg. 28,778 (June 2, 1995). The Patent and Trademark Office also issued a supporting legal analysis for the proposed guidelines on Oct. 3, 1995.

[18] The Court of Appeals for the Federal Circuit is the designated appellate tribunal for all patent-related cases from the U.S. district courts. 28 U.S.C. §1295(a). The U.S. district courts have original and exclusive jurisdiction over all patent-related matters. 28 U.S.C. §1338.

[19] *Guidelines*, 61 Fed. Reg. 7478, 7482; *O'Reilly v. Morse*, 56 U.S. (15 How.) 62 (1854) (a patent claim to the telegraph was so broadly written that it covered a basic theory of magnetism and hence did not constitute statutory subject matter. Other claims to the telegraph were upheld as being directed to machines).

[20] *Guidelines*, 61 Fed. Reg. 7478, 7485; *Parker v. Flook*, 437 U.S. 584, 198 U.S.P.Q. 193 (1978) (a claim for updating alarm limits was held to be not patentable); *Gottschalk v. Benson*, 409 U.S. 63 (1972) (a claim for an electronic method of converting a binary number to a decimal number was held to be not patentable as a mathematic formula).

[21] *Guidelines*, 61 Fed. Reg. 7478, 7482, *citing O'Reilly v. Morse*, 56 U.S. (15 How.) 62, 114-19 (1854).

[22] *Guidelines*, 61 Fed. Reg. 7478, 7482.

[23] *Id.* at 7483.

[24] *Id.*

[25] *Id.*

[26] *Arrhythmia Research Tech. v. Corazonix Corp.*, 958 F.2d 1053, 22 U.S.P.Q.2d 1033 (Fed. Cir. 1992).

[27] *In re Abele*, 684 F.2d 902, 214 U.S.P.Q. 682 (CCPA 1982).

[28] *In re Taner*, 681 F.2d 787, 214 U.S.P.Q. 678 (CCPA 1982).

[29] *Guidelines*, 61 Fed. Reg. 7478, 7484.

[30] The Supreme Court held that Congress chose very expansive language in the patent statute, 35 U.S.C. §101, such that "anything under the sun that is made by man" is patentable subject matter. *Diamond v. Chakrabarty*, 447 U.S. 303, 308-09, 206 U.S.P.Q. 193, 197 (1980) (an oil-consuming bacteria, classified as a life form, is patentable).

[31] *In re Abele*, 684 F.2d 902, 905-07, 214 U.S.P.Q. 682, 685-87 (CCPA 1982); *In re Walter*, 618 F.2d 758, 767, 205 U.S.P.Q. 397, 406-07 (CCPA 1980); *In re Freeman*, 573 F.2d 1247, 1245, 197 U.S.P.Q. 464, 471 (CCPA 1978).

[32] *State Street Bank and Trust Co. v. Signature Financial Group, Inc.*, 38 U.S.P.Q.2d 1530 (D. Mass. 1996).

[33] *Id.* note 7, at 1539.

[34] *In re Trovato*, 60 F.3d 807, 35 U.S.P.Q.2d 1570 (Fed. Cir. 1995).

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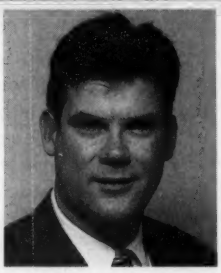

Robert Kain, a member of the Miami law firm of Cesarano, Kain & Van Der Wall, P.L., has been involved in the computer law and intellectual property law (patent, trademark, copyright, and trade secret) fields for almost 20 years as a registered patent attorney with the U.S. Patent and Trademark Office. Formerly, he was patent counsel with General Electric and an adjunct professor of law at Nova Southeastern Law School in Ft. Lauderdale (teaching patent law). He has a J.D., a B.E. in electrical engineering, and a B.S. in engineering science.

This column is submitted on behalf of the General Practice Section, Timothy S. Shaw, chair, and David A. Donet, editor.

■

BOOKS

Reel Justice—The Courtroom Goes to the Movies

by Paul Bergman and Michael Asimow
Reviewed by Ellen B. Gwynn

Bergman and Asimow, law professors at the University of California at Los Angeles, have written an entertaining book for people who enjoy law-related films.

Reel Justice provides detailed descriptions of 69 movies, beginning with *M*, a 1931 German film involving an insanity defense, through the 1995 American film *Losing Isaiah*, about a custody dispute. The book is divided into categories, including comedies (*Adam's Rib, Bananas*), true stories (*A Man for All Seasons, Reversal of Fortune*), military subjects (*Breaker Morant, A Few Good Men*).

The authors provide a one-sentence synopsis and technical information about each film, a detailed description of the plot, and a thorough analysis of the legal issues raised. Many include a "trial brief," adding interesting information about the context of the film or backgrounds of the characters. The movies are rated on a scale of one to four gavels, based upon "the quality, dramatic power, and authenticity of the trial scenes." Thus, *And Justice for All,* which won Al Pacino an Academy Award nomination, but was basically ridiculous from a lawyer's point of view, deservedly earns but one gavel.

The movies are also conveniently listed in an appendix according to their rankings, so you can easily pick out only the best movies to see. Taking this approach, I rented a 1991 British film based upon a true story of a young man who faced the death penalty, even though he was mentally retarded, called *Let Him Have It,* which was excellent; the hilarious *My Cousin Vinny*, a 1992 movie about a novice New Yawk lawyer who descends upon a small Alabama town with his fiancee, Mona Lisa Vito, to defend his cousin unjustly accused of murder, which has more realistic courtroom scenes than most Hollywood dramas; and the delightful 1957 *Witness for the Prosecution*, starring Charles Laughton, Tyrone Power, and Marlene Dietrich, the story of a murder trial with a surprising plot twist. The authors include a "surprise ending warning" for movies like the latter, advising against reading the summary before the movie, but I found it more enjoyable to read each summary only after watching the movie, not just those with surprise endings.

The only criticism of *Reel Justice* is of the crude and sophomoric humor scattered throughout. The authors cannot seem to refrain from making innumerable sex jokes and quips in extremely poor taste. This repeatedly detracts from otherwise insightful accounts. *Reel Justice* (338 pp.) is published by Andrews & McMeel, Kansas City, Mo., and sells for $14.95.

Ellen B. Gwynn is a senior law clerk with the First District Court of Appeal, Tallahassee.

Law School Without Fear: Strategies for Success

by Helene S. and Marshall S. Shapo

What should parents tell a child who decides to go to law school? If the parents are law professors, they might turn sage advice into a book, which is what two professors from Northwestern University of Law did.

This book represents almost a half century between the two law professors of teaching students about the intricacies of the law and legal writing; of witnessing the inevitable panic of first-year law school; and of repeatedly assuring students that, yes, they too can master what seem to be four or five new sets of vocabulary while learning a new way to think.

The Shapos' words of wisdom to a son who was beginning to ask the same questions they had been hearing repeatedly from their students have evolved into a plain spoken and clearly written road map for overcoming the recurrent hurdles that all law students face.

The book presents practical tips to help students sort out competing demands on their time, understand basic legal concepts, and deal with the stress of law school. Included is a chapter with tips about reviewing and outlining material in order to understand and retain it.

Readers are offered an extensive glimpse at the court system, basic motions in a trial, and the type of policies that courts apply in difficult cases. Many examples are drawn from first-year courses—civil procedure, contracts, criminal law, property, legal writing, and torts.

Law School Without Fear outlines the new vocabulary and new forms of analysis law students need to learn, with concise explanations of terminology, concepts, and analytical techniques. In the process, it suggests ways to cope with unsettling aspects of the study of law, such as the seeming lack of clear rules and the nature of legal argument.

The Shapos advise students to give themselves permission to feel overwhelmed. They also emphasize the need for exercise and recreation to overcome the major emotional difficulties they have encountered in their students over the years. Above all, the Shapos stress the need for students to preserve their humanity in a highly competitive environment.

Law School Without Fear: Strategies for Success (200 pages) is published by Foundation Press, Westbury, New York.

Have You Read a Good Book?

Members of the Bar are encouraged to submit brief book reviews (approximately 500 words). They should be related to law but may be practical, esoteric, entertaining or even fiction. Reviews should include the number of pages, publisher, and cost. Send reviews to Editor, The Florida Bar *Journal,* 650 Apalachee Parkway, Tallahassee 32399-2300. Reviews will be published on a space-available basis.

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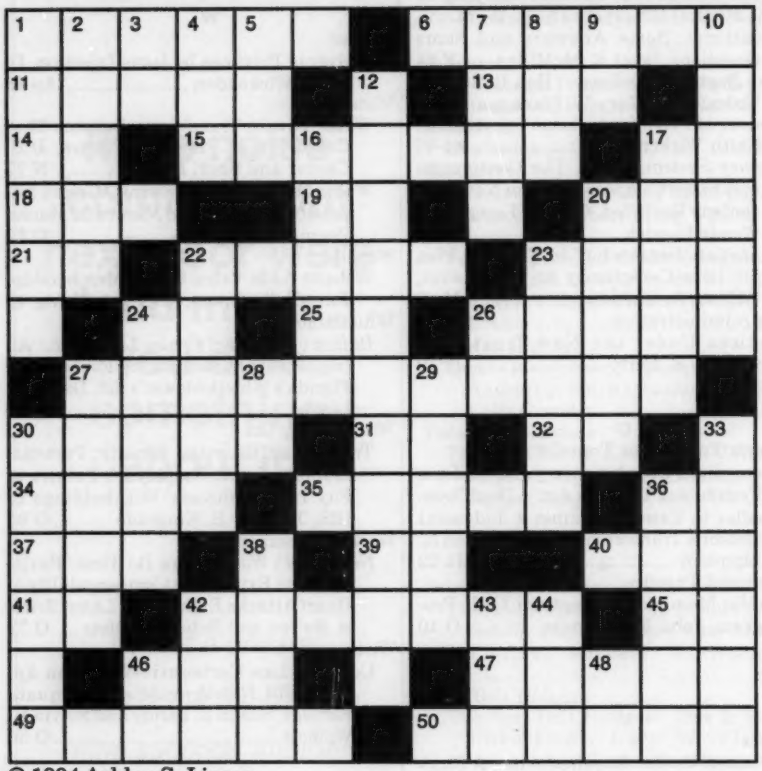

ACROSS

1. Southern for "I have completed my prima facie case."
6. A somewhat outdated dictionary uniformly sold to neophyte law students, much as swamp-lands are sold to doctors.
11. To date lawfully.
13. United Nations Organization.
14. Actress Garr of Close Encounters.
15. Willingly.
17. Suggests to feminists the clear and present danger of a potential chauvinist.
18. Comparative suffix.
19. Leave.
20. A style of Algerian popular music played on an electric guitar.
21. Overtime.
22. A single-word oxymoron when used to describe a pleading.
23. Stool pigeon or songbird.
24. Exist.
25. Accounts Receivables.
26. When a poet represents himself in court (two Latin words or one English word—Take your pick).
27. A cross between a guess (which is speculative and, therefore, objectionable) and an estimate, which is permitted.
30. A warrant that guarantees one a seat in court, no matter how crowded the courtroom may be.
31. Infernal Revenue.
32. Those who foot the bill for government corruption and waste.
34. The remedy, legal or equitable, involves scratch.
35. Phoney intellectual.
36. Doctor of Science.
37. Gran Turismo Omologato.
39. Prefix meaning to cause to be.
40. Securities and Exchange Commission.
41. A vote in favor of something.
42. In most states, it's the highest court, excepting New York, where it's the lowest.
45. The McFadden Act or your mama; take your pick.
46. To be smoked, but not inhaled.
47. A snake ordering someone to stop.
49. Color of canine agreement that forbids employees from joining unions.
50. Second word of term for 33 Down.

DOWN

1. Term for lawsuit designed to mislead clients into believing that something is actually going to happen with their cases.
2. What's another word for "Thesaurus?" Who else would you ask?!
3. Regulated Unit (environmental law acronym).
4. Tug on Superman's cape, bungle, foul up, mess up, make a mistake, or play poker with someone whose name starts with a city.
5. Referring to a woman saint, or a suite.
7. Locally Unwanted Land Use (or friend of Tubby).
8. Taking your pick.
9. Supplier of health care, money, workers' compensation, unemployment and severance benefits, right up until the time it's taxed out of existence.
10. It used to be something that professional batters wanted to avoid; now it seems to be a goal.
12. The late-night lawyers who proclaim "No fee unless justice is done" or "If I can't beat your rap, I'll eat a bug."
16. Phoney name.
17. House occupied by a minister or a famous cult killer.
20. Trendy new approach to demonstrating dissatisfaction with jury verdicts.
22. Any tree of the genus Fagus.
23. A misrepresentation of a material fact intended to deceive.
24. Swindle in which a person is persuaded to buy a nonexistent, unsalable, or worthless object or benefit (such as paying taxes into the Social Security system).
26. The evening time.
27. Got rich from oil, liked paintings, and thus collected oils paintings.
28. Calling for quiet in the courtroom.
29. Sleepy female juror.
30. Double jeopardy.
33. First of two words (see 50 Across for the second) to describe what the elves will do when they learn that the North Pole has been condemned for a new super highway.
36. Beat-up, abused, used merchandise that retailers pass off as near-new.
38. Annuity for personal injury attorneys.
42. Fifth tone of a diatonic scale.
43. A form of Melvin.
44. Endangered Species Act.
46. Plural.
48. Day when the High Court justices begin their sit.

Solution on Page 87.

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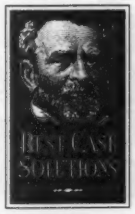

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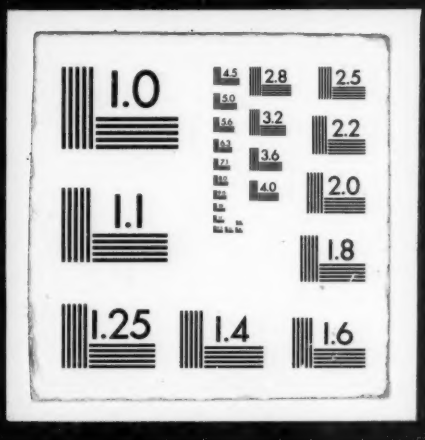
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